GENERAL PRINCIPLES OF COMPANY LAW

QUESTION 1

What is a Company? What are the different kinds of Company? What are the advantages of incorporation of a Company?

1. Introduction

A company is one of the most important forms of business organisation. Under the Companies Act, 2013, a company is an incorporated association having a separate legal personality distinct from its members.

The Companies Act, 2013 governs the incorporation, management and winding up of companies in India.

2. Definition of Company

Section 2(20) of the Companies Act, 2013 defines a company as:

"Company means a company incorporated under this Act or under any previous company law."

Thus, a company comes into existence only after incorporation under the Companies Act or the applicable previous company law.

3. Essential Characteristics of a Company

1. Separate Legal Personality

A company is a legal person separate from its shareholders and directors.

The leading case is:

Salomon v. A. Salomon & Co. Ltd. (1897)

The House of Lords held that once a company is properly incorporated, it becomes a separate legal person from its members.

Therefore, the company's debts are generally its own debts and not the personal debts of shareholders.

2. Limited Liability

In a company limited by shares, the liability of shareholders is generally limited to the unpaid amount on their shares.

For example, if a shareholder holds shares of ₹1,00,000 and has already paid ₹80,000, his normal liability is limited to the remaining ₹20,000.

3. Perpetual Succession

The existence of a company is not affected by the death, insolvency or retirement of its members.

The company continues until it is legally wound up.

The principle is often expressed as:

"Members may come and members may go, but the company continues."

4. Separate Property

A company can own property in its own name.

In Macaura v. Northern Assurance Co. Ltd., it was recognised that company property is distinct from the property of its shareholders.

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5. Capacity to Sue and be Sued

A company can institute legal proceedings and proceedings can also be instituted against it in its corporate name.

6. Transferability of Shares

Shares of a company are generally transferable subject to the Companies Act and the Articles of Association.

In a public company, shares are generally freely transferable, whereas a private company places restrictions on transfer.

7. Artificial Legal Person

A company is not a natural human being. It is an artificial legal person created by law.

It can enter into contracts, own property and incur liabilities through its authorised human agents.

4. Different Kinds of Companies

Companies may be classified in several ways.

A. On the Basis of Liability

1. Company Limited by Shares

The liability of members is limited to the unpaid amount on their shares.

2. Company Limited by Guarantee

Members undertake to contribute a specified amount to the assets of the company in the event of winding up.

3. Unlimited Company

The liability of members is not limited.

B. On the Basis of Number of Members

1. Private Company

Under Section 2(68), a private company generally:

- restricts the right to transfer its shares;
- limits the number of members to 200, subject to statutory exclusions; and
- prohibits invitation to the public to subscribe for its securities.

2. Public Company

A public company is a company which is not a private company.

It may raise capital from the public subject to the provisions of the Companies Act and securities laws.

3. One Person Company

Section 2(62) recognises an One Person Company (OPC), which has only one member.

C. Other Important Types

1. Government Company

Under Section 2(45), a Government company is one in which not less than 51% of the paid-up share capital is held by the Central Government, State Government or Governments, or partly by the Central and partly by one or more State Governments.

2. Foreign Company

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Section 2(42) deals with a foreign company having a place of business in India and conducting business activity in India in accordance with the statutory requirements.

3. Holding Company

Section 2(46) defines a holding company as a company of which one or more companies are subsidiary companies.

4. Subsidiary Company

Section 2(87) deals with subsidiary companies.

5. Section 8 Company

A Section 8 company is formed for charitable or other specified objects such as:

- promotion of commerce;
- art;
- science;
- sports;
- education;
- research;
- social welfare;
- religion;
- charity; etc.

Its profits are applied towards its objects and dividends are not distributed to members.

6. Small Company

Section 2(85) recognises a small company subject to the prescribed statutory limits and exclusions.

7. Listed and Unlisted Companies

A company whose securities are listed on a recognised stock exchange is generally referred to as a listed company.

A company whose securities are not listed is an unlisted company.

5. Advantages of Incorporation

1. Separate Legal Entity

The company has an identity separate from its members.

This is the most important advantage of incorporation.

2. Limited Liability

Members enjoy limited liability where the company is limited by shares or guarantee.

3. Perpetual Succession

Death or insolvency of shareholders does not normally bring the company to an end.

4. Ownership of Property

The company can acquire and hold property in its own name.

5. Ability to Sue and be Sued

The company can independently enforce its legal rights.

6. Easy Mobilisation of Capital

A company can raise capital through:

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- issue of shares;
- debentures;
- loans;
- private placement;
- public issue, where permitted.

7. Transferability of Shares

Shares provide a convenient method for transferring ownership interests, subject to applicable restrictions.

8. Greater Business Stability

The corporate structure allows business activities to continue despite changes in membership or management.

9. Credibility

Incorporation creates a formal legal structure and may increase confidence among investors, lenders and commercial parties.

10. Independent Management

Ownership and management may be separated. Shareholders may appoint directors to manage the company's affairs.

6. Disadvantages of Incorporation

For a balanced LL.M. answer, you may also mention:

- numerous statutory compliances;
- maintenance of books and records;
- filing of returns;
- audit requirements;
- restrictions on management;
- disclosure requirements;
- cost of incorporation and compliance.

7. Conclusion

A company is an artificial legal person created by law and having an identity separate from its members. The doctrines of separate legal personality, limited liability and perpetual succession make incorporation an attractive form of business organisation.

The Supreme Court and courts in India have consistently recognised the separate legal personality of companies, subject to exceptional circumstances where the corporate veil may be lifted.

The Companies Act, 2013 provides a comprehensive framework for different forms of companies and their incorporation, management and regulation.

⭐ Important cases to remember for Q1

1. Salomon v. Salomon & Co. Ltd. (1897) – Separate legal personality
2. Lee v. Lee's Air Farming Ltd. (1961) – Company separate from its controlling shareholder/director

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3. Macaura v. Northern Assurance Co. Ltd. (1925) – Company property is distinct from members' property

Exam conclusion line:

"Thus, incorporation transforms an association of persons into a distinct juristic person, thereby providing separate legal personality, limited liability and perpetual succession."

QUESTION 2

Who is a Promoter? What are the Duties and Liabilities of a Promoter?

1. Introduction

A promoter plays a vital role in bringing a company into existence. Before incorporation, someone must conceive the business idea, make preliminary arrangements, acquire property, prepare documents and take steps for registration.

The Companies Act, 2013 specifically recognises the position of a promoter.

2. Definition of Promoter

Section 2(69) of the Companies Act, 2013 defines a promoter as a person:

1. who has been named as such in the prospectus or identified by the company in the annual return; or
2. who has control over the affairs of the company, directly or indirectly, whether as shareholder, director or otherwise; or
3. in accordance with whose advice, directions or instructions the Board of Directors is accustomed to act.

However, a person acting merely in a professional capacity is not treated as a promoter merely because he gives professional advice.

3. Who Can Be a Promoter?

A promoter may be:

- an individual;
- a company;
- a partnership or association;
- an existing shareholder;
- a director;
- a professional person, where he assumes the role of promoter rather than merely providing professional services.

4. Legal Position of Promoter

A promoter is not exactly an agent of the company before incorporation, because the company does not yet legally exist.

A promoter is also not technically a trustee, but courts describe the promoter as standing in a fiduciary relationship with the company.

Therefore, the promoter must act honestly and make full disclosure.

5. Duties of a Promoter

1. Duty to Disclose Material Facts

The promoter must disclose all material facts relating to transactions involving the company.

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2. Duty to Avoid Secret Profits

A promoter cannot make a secret profit at the expense of the company.

If he makes a profit from a transaction involving the company, he must make proper disclosure.

Case:

Erlanger v. New Sombrero Phosphate Co. (1878)

The promoter purchased property and sold it to the company at a profit without adequate disclosure.

The court emphasised the promoter's fiduciary duties.

3. Duty to Disclose Personal Interest

If the promoter has an interest in property being sold to the company, that interest must be properly disclosed.

4. Duty of Good Faith

A promoter must act honestly and in the interests of the proposed company.

5. Duty Regarding Prospectus

Where a prospectus is issued, the promoter must ensure that material facts are properly disclosed and that misleading statements are not made.

6. Duty to Return Secret Profits

If a promoter obtains an undisclosed profit, the company can seek recovery of that profit.

6. Liabilities of Promoter

1. Liability for Misstatement in Prospectus

Sections 34 and 35 impose criminal and civil liabilities in appropriate circumstances for misstatements or misleading statements in a prospectus.

2. Liability for Fraud

Section 447 provides consequences for fraud.

3. Liability for Secret Profit

The company may:

- recover the secret profit;
- rescind the transaction in appropriate cases;
- claim damages where legally available.

4. Liability for Non-disclosure

Failure to disclose material facts may make the promoter liable to the company.

5. Liability in Relation to Preliminary Contracts

Contracts entered into by promoters before incorporation do not automatically become contracts of the company because the company did not exist at that time.

A fresh contract or valid adoption/novation mechanism may be necessary.

7. Rights of Promoter

A promoter does not automatically have a statutory right to remuneration.

However, remuneration may arise through:

- contract;

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- articles;
- payment of commission where legally permitted;
- sale of property to the company;
- shares or other agreed consideration.

8. Conclusion

The promoter occupies a fiduciary position towards the company. The fundamental principle governing promoters is complete honesty, good faith and full disclosure.

A promoter may earn legitimate profits, but he cannot obtain secret profits by concealing material facts from the company.

⭐ Important case

Erlanger v. New Sombrero Phosphate Co. – promoter's fiduciary duties and disclosure of profit.

Definition → Statutory provisions → Explanation → Duties/Types → Case law → Conclusion.

QUESTION 3

Define Prospectus. What are the contents of a Prospectus? What are the remedies available for misrepresentation in a Prospectus?

1. Introduction

A prospectus is an important document through which a public company invites the public to subscribe to or purchase its securities. It enables prospective investors to make an informed decision regarding investment.

The Companies Act, 2013 contains detailed provisions relating to prospectus, particularly Sections 23 to 41.

2. Definition of Prospectus

Section 2(70) of the Companies Act, 2013 defines “prospectus” as any document described or issued as a prospectus.

It also includes:

- a red herring prospectus under Section 32;
- a shelf prospectus under Section 31; and
- any notice, circular, advertisement or other document inviting offers from the public for subscription to or purchase of securities of a body corporate.

Simple definition

A prospectus is a document issued by or on behalf of a public company inviting the public to subscribe to or purchase its securities.

3. Object of a Prospectus

The main purpose of a prospectus is to provide investors with true, complete and material information about the company and the securities offered.

Its important objects are:

1. To invite the public to subscribe to securities.
2. To provide material information to investors.

3. To enable investors to assess the financial position of the company.
4. To ensure transparency in public issues.
5. To prevent fraudulent inducement of investors.
6. To impose liability upon persons responsible for false or misleading statements.

4. Statutory Provisions Relating to Prospectus

Important provisions include:

Section	Subject
Section 2(70)	Definition of prospectus
Section 25	Document containing offer of securities for sale deemed to be prospectus
Section 26	Matters to be stated in prospectus
Section 27	Variation in terms of contract or objects in prospectus
Section 28	Offer of sale of shares by certain members
Section 31	Shelf prospectus
Section 32	Red herring prospectus
Section 34	Criminal liability for misstatements
Section 35	Civil liability for misstatements
Section 36	Fraudulently inducing persons to invest
Section 37	Action by affected persons
Section 38	Punishment for personation for acquisition of securities

5. Contents of Prospectus

Section 26 provides for matters to be stated in a prospectus. The prospectus must contain the information and financial reports specified under the applicable legal and SEBI framework.

For examination purposes, the important contents can be discussed under the following heads.

A. General Information

The prospectus should contain information relating to:

- name of the company;
- registered office;
- date of incorporation;
- nature of business;
- objects of the company;
- details of the issue;
- opening and closing dates of the issue;
- terms of the issue.

B. Capital Structure

It should disclose information regarding:

- authorised capital;
- issued capital;
- subscribed capital;
- paid-up capital;
- existing shareholding;
- proposed issue of securities;
- details of promoters' contribution, where applicable.

C. Details of Directors and Promoters

The prospectus should provide relevant information regarding:

- directors;
- proposed directors;
- promoters;
- managerial personnel;
- their interests in the company;
- remuneration and other relevant particulars.

D. Objects of the Issue

The prospectus must explain the purposes for which the money raised from the public is proposed to be utilised.

For example:

- expansion;
- acquisition of assets;
- repayment of loans;
- working capital;
- new projects.

E. Financial Information

Financial information is one of the most important parts of a prospectus.

It should contain the prescribed financial information and reports so that investors can assess:

- profitability;
- assets and liabilities;
- financial position;
- earnings;
- business performance.

Section 26 specifically requires the prospectus to state such information and financial reports as specified by SEBI in consultation with the Central Government.

F. Risk Factors

The prospectus should disclose material risks associated with:

- the business;
- the industry;
- the securities;

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- financial position;
- litigation;
- regulatory matters;
- other material circumstances.

This enables investors to understand the risks before investing.

G. Details of Litigation

Material pending litigation and regulatory proceedings involving the company, promoters or directors should be disclosed as required by applicable regulations.

H. Underwriting and Subscription

Where applicable, the prospectus should disclose:

- details of underwriters;
- underwriting arrangements;
- minimum subscription;
- issue-related arrangements.

I. Expert's Statement

Where a statement is made by an expert, Section 26 contains specific requirements.

An expert whose statement is included must satisfy the statutory requirements and provide the required written consent.

J. Declaration Regarding Compliance

The prospectus must contain the required declaration regarding compliance with applicable provisions of:

- Companies Act, 2013;
- Securities Contracts (Regulation) Act, 1956;
- SEBI Act, 1992; and
- rules and regulations made thereunder.

6. Misrepresentation in a Prospectus

A misrepresentation occurs when a prospectus contains:

- an untrue statement;
- a misleading statement;
- a false representation; or
- an omission of a material fact which makes the prospectus misleading.

Thus, liability may arise not only from what is wrongly stated but also from what has been improperly omitted.

7. Remedies for Misrepresentation in Prospectus

The Companies Act provides both civil and criminal consequences.

A. Criminal Liability — Section 34

Section 34 provides criminal liability for misstatements in a prospectus.

Where the prospectus contains an untrue or misleading statement, or an inclusion or omission likely to mislead, persons who authorised the issue may be liable under Section 447 relating to fraud.

Defence

A person may avoid liability in appropriate circumstances by proving, among other things, that:

- the statement or omission was immaterial; or
- he had reasonable grounds to believe that the statement was true; and
- he continued to believe it to be true until the prospectus was issued.

8. Civil Liability — Section 35

Section 35 deals with civil liability for misstatements.

Where a person subscribes for securities relying on a misleading statement or omission in the prospectus and suffers loss or damage, specified persons may be liable to pay compensation.

Persons who may be liable include:

1. Directors at the time of issue;
2. persons named as directors or proposed directors;
3. promoters;
4. persons who authorised the issue of the prospectus; and
5. experts referred to in Section 26(5), subject to statutory requirements.

Fraudulent Prospectus

If the prospectus was issued with an intent to defraud, the persons covered by Section 35 may become personally responsible, without limitation, for losses or damages suffered by persons who subscribed on its basis.

9. Fraudulently Inducing Investment — Section 36

Section 36 applies where a person knowingly or recklessly:

- makes a false, deceptive or misleading statement;
- makes a misleading promise or forecast; or
- deliberately conceals a material fact,

with the intention of inducing another person to enter into an agreement relating to securities.

Such conduct attracts action under Section 447.

10. Action by Affected Persons — Section 37

Section 37 provides an important remedy.

A person, group of persons or association of persons affected by a misleading statement or omission in a prospectus may institute a suit or take other appropriate action under Sections 34, 35 or 36.

11. Common Law Remedies

Apart from statutory remedies, the traditional remedies for fraudulent or material misrepresentation may include:

1. Rescission

The investor may seek cancellation of the contract and return of the investment, subject to the principles governing rescission.

2. Damages

Where the legal requirements are satisfied, the investor may claim damages for loss caused by the misrepresentation.

3. Compensation

Section 35 specifically provides statutory compensation where its conditions are satisfied.

4. Criminal Action

Where the conduct amounts to fraud or attracts Section 34/36, criminal consequences may follow.

12. Important Case Laws

1. Derry v. Peek (1889)

The case explains the principles relating to fraudulent misrepresentation.

The court distinguished fraud from an innocent mistake and emphasised the importance of absence of honest belief.

2. New Brunswick & Canada Railway Co. v. Muggeridge

The case emphasised the duty to make full and fair disclosure of material facts in a prospectus.

3. Rex v. Kylsant

The court dealt with a prospectus containing statements which were technically true in some respects but misleading because of material omissions.

The principle is important:

A prospectus must not merely contain technically true statements; it must not create a misleading impression in the mind of investors.

13. Difference Between Civil and Criminal Liability

Civil Liability	Criminal Liability
Mainly Section 35	Mainly Section 34
Compensation to affected investors	Punishment under Section 447
Loss or damage is important	Misstatement/omission attracting statutory criminal liability
Investor may claim compensation	State prosecution/criminal proceedings
Statutory defences available	Statutory defence under Section 34

14. Conclusion

A prospectus is an important instrument for protecting investors in a public issue. The fundamental principle is that the prospectus must disclose material information accurately and must not mislead investors either by false statements or material omissions.

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The Companies Act, 2013 therefore imposes civil liability, criminal liability and other consequences upon persons responsible for misleading prospectuses. Sections 34, 35, 36 and 37 provide a strong statutory framework for protecting investors.
Prospectus → Section 2(70)
Contents → Section 26
Criminal liability → Section 34
Civil liability → Section 35
Fraudulently inducing investment → Section 36
Action by affected persons → Section 37
Best cases:
Derry v. Peek → Fraudulent misrepresentation
New Brunswick Railway case → Full and fair disclosure
Rex v. Kylsant → Technically true but misleading prospectus

QUESTION 4

Explain the Doctrine of Ultra Vires

1. Introduction

The Doctrine of Ultra Vires is one of the fundamental principles of Company Law. The expression "ultra vires" means "beyond the powers."
A company is an artificial legal person created by law. It can exercise only those powers which are conferred upon it by:

- the Companies Act;
- its Memorandum of Association;
- its Articles of Association; and
- other applicable laws.

Section 4(1)(c) of the Companies Act, 2013 requires the Memorandum of Association to state the objects for which the company is proposed to be incorporated and matters considered necessary in furtherance thereof.
Therefore, an act done by a company beyond the objects or powers contained in its Memorandum is generally called an ultra vires act.

2. Meaning of Ultra Vires

The term ultra vires literally means "beyond the powers."
In company law, an act is ultra vires when it is beyond the legal powers of the company.
Example
Suppose the Memorandum of a company states that its object is:
"To manufacture and sell pharmaceutical products."
If the company uses its funds to establish an unrelated business, such as a banking business, without the necessary legal authority, the transaction may be beyond its corporate powers.

3. Object of the Doctrine

The doctrine has been developed mainly to:

1. protect shareholders;

2. protect creditors;
3. ensure that company funds are used only for authorised purposes;
4. prevent directors from exceeding their authority;
5. maintain the objects stated in the Memorandum;
6. ensure that the company does not act beyond its legal capacity.

4. Importance of the Memorandum

The Memorandum of Association is the constitutional document that defines the fundamental limits of the company's powers.

Section 4 specifically requires the objects of the company to be stated in the Memorandum.

Therefore:

Memorandum → Objects → Powers of the Company

The company cannot normally use its corporate powers for purposes outside those objects.

5. Leading Case — Ashbury Railway Carriage & Iron Co. Ltd. v. Riche

This is the most important case for the doctrine of ultra vires.

Facts

The objects of the company included construction and working of railway lines and related activities.

The company entered into a contract with Riche for financing and construction of a railway.

The contract was not within the company's stated objects.

Decision

The House of Lords held that the contract was ultra vires the company and therefore void.

Even unanimous consent of the shareholders could not make the transaction valid.

Principle

An act beyond the objects of the company is ultra vires and cannot be ratified merely by shareholder approval.

For examination, this case should definitely be mentioned.

6. Ultra Vires the Company and Ultra Vires the Directors

This distinction is very important.

A. Act Ultra Vires the Company

An act is ultra vires the company when it is beyond the company's corporate objects or legal powers.

Effect:

Such an act is generally void and cannot be ratified even by all the shareholders.

This is the strictest form of ultra vires.

The Supreme Court has also recognised the principle that where a company act is ultra vires its objects, it is void and cannot be validated merely because shareholders agree.

B. Act Ultra Vires the Directors but Intra Vires the Company

Sometimes an act is within the company's objects but the directors have exceeded their authority.

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For example, the company has power to borrow money, but the Articles permit the directors to borrow only up to ₹10 crore without shareholder approval.
If directors borrow ₹15 crore without the required approval, the act may be ultra vires the directors, but not necessarily ultra vires the company.
Effect
The company may be able to ratify such an act, depending on the circumstances and applicable law.
7. Act Ultra Vires the Articles
The Articles of Association regulate the internal management of the company.
If directors do something contrary to the Articles but the act is within the company's Memorandum and legal powers, the defect may generally be capable of being cured by following the proper procedure or altering the Articles where permitted.
Therefore:
Ultra vires Memorandum → generally void and incapable of ratification
Ultra vires Articles → may generally be cured/ratified if legally permissible

8. Act Ultra Vires the Companies Act
An act contrary to a mandatory provision of the Companies Act cannot be validated merely by the Memorandum, Articles or shareholder resolution.
Section 6 expressly provides that the Companies Act prevails over anything contrary contained in the Memorandum, Articles, agreements or resolutions.
Therefore:
The Act prevails over the Memorandum and Articles.
9. Consequences of an Ultra Vires Act
1. The Act is Void
An act which is ultra vires the company is generally void.
It does not create enforceable corporate rights and obligations in the ordinary way.
2. It Cannot Be Ratified
An act that is truly ultra vires the company cannot be ratified even by the unanimous consent of shareholders.
This is the principle established in Ashbury Railway Carriage & Iron Co. Ltd. v. Riche.
3. Injunction
Members may seek an injunction to prevent the company from carrying out a proposed ultra vires act.
Section 245(1)(a) specifically permits eligible members/depositors to approach the Tribunal in a class action seeking an order restraining the company from committing an act ultra vires the Memorandum or Articles.
4. Directors May Be Personally Liable
If directors use company funds for an ultra vires purpose, they may in appropriate circumstances be required to restore the funds or compensate the company.

5. Property Acquired Ultra Vires

If the company acquires property through an ultra vires transaction, legal consequences depend on the circumstances. The company may in appropriate cases assert rights relating to property or trace funds used in the transaction.

6. Injunction by Members

Members can seek judicial/tribunal intervention to prevent an ultra vires transaction before it is completed.

10. Exceptions / Limitations

The doctrine must be applied carefully because not every irregular corporate act is ultra vires the company.

1. Acts Within the Objects but Beyond Directors' Authority

Such acts may be ratified by the company where legally permissible.

2. Acts Incidental or Ancillary to the Main Objects

The company can perform acts that are reasonably incidental or conducive to achieving its stated objects.

For example, if a company is formed to manufacture automobiles, it can ordinarily:

- purchase machinery;
- employ workers;
- lease premises;
- borrow money within its lawful powers;
- enter supply contracts.

These are not necessarily ultra vires merely because they are not expressly written word-for-word in the objects clause.

3. Alteration of Objects

The Companies Act provides mechanisms for alteration of the Memorandum.

Section 13 permits alteration of the Memorandum subject to the statutory procedure. In certain cases, especially where money has been raised from the public through a prospectus and remains unutilised, additional requirements apply.

Thus, a company need not remain permanently restricted to an outdated object clause; it can change its objects by following the law.

11. Doctrine of Ultra Vires and Doctrine of Indoor Management

These doctrines should not be confused.

Ultra Vires	Indoor Management
Protects the company, shareholders and creditors	Protects outsiders dealing with the company
Concerned with powers of the company	Concerned with internal procedures
Act beyond corporate objects is generally void	Outsider may assume internal procedures have been properly followed

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Ultra Vires	Indoor Management
Cannot generally be ratified if ultra vires company	Internal irregularity may not affect outsider
Leading case: Ashbury Railway	Leading case: Royal British Bank v. Turquand

12. Doctrine of Constructive Notice

The doctrine of constructive notice is closely connected with ultra vires.

The Memorandum and Articles are public documents. Persons dealing with the company are generally deemed to have notice of their contents.

Therefore, an outsider cannot ordinarily claim ignorance of the company's publicly available constitutional documents.

However, constructive notice does not mean that an outsider is presumed to know every internal procedure actually followed by the company.

That is where the doctrine of indoor management provides protection.

13. Importance of the Doctrine

The doctrine remains important because it:

Protects shareholders

Company money cannot ordinarily be diverted to purposes outside the company's objects.

Protects creditors

Creditors can rely on the principle that corporate assets should be applied for lawful corporate purposes.

Controls directors

Directors cannot treat company property as if it were their personal property.

Promotes corporate discipline

It ensures that the company operates according to its constitutional documents and statutory powers.

14. Important Case Laws

☆ 1. Ashbury Railway Carriage & Iron Co. Ltd. v. Riche (1875)

Principle: Act beyond the objects clause is ultra vires and void.

☆ 2. A. Lakshmanaswami Mudaliar v. LIC of India

The Supreme Court of India applied the doctrine in relation to the objects of a company and held that corporate funds could not be applied for purposes outside the company's objects.

The Supreme Court judgment records that the donation was outside the objects and therefore ultra vires; such an act could not be ratified merely by shareholder agreement.

3. Attorney General v. Great Eastern Railway Co.

The case recognised that acts reasonably incidental to the company's objects may be valid even though they are not expressly mentioned in the Memorandum.

4. Royal British Bank v. Turquand

Important for distinguishing indoor management from ultra vires.

15. Ultra Vires — Simple Chart for Examination

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Company's Powers

↓

Memorandum of Association

↓

Objects Clause

↓

Is the act within the objects?

YES → Generally intra vires company

NO → Ultra vires company

↓

Generally void

↓

Cannot be ratified by shareholders

16. Conclusion

The Doctrine of Ultra Vires is a fundamental principle of company law which prevents a company from acting beyond the objects and powers for which it was incorporated.

The doctrine protects shareholders, creditors and the company itself from unauthorised use of corporate powers. Under the Companies Act, 2013, the objects clause continues to form an important part of the Memorandum under Section 4, while Section 6 ensures that statutory provisions prevail over contrary provisions in the company's constitutional documents.

⭐ Must remember for the exam

Ultra Vires = Beyond powers

Section 4(1)(c) → Objects in Memorandum

Section 6 → Act prevails over MOA/AOA

Section 13 → Alteration of Memorandum

Section 245(1)(a) → Tribunal can restrain ultra vires acts in class action

Ashbury Railway Carriage v. Riche → Most important case

A. Lakshmanaswami Mudaliar v. LIC → Important Indian case

Royal British Bank v. Turquand → Indoor management

One-line conclusion for writing in the examination:

“An act which is ultra vires the company is void and cannot ordinarily be ratified even by the unanimous consent of all its members.”

QUESTION 5

What do you mean by Allotment of Shares? Explain the Statutory Rules regarding Allotment of Shares.

1. Introduction

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Allotment of shares is an important stage in the process of raising share capital. After a company invites applications for its shares, it has to decide which applicants will be issued shares and in what number.

The Companies Act, 2013 contains specific provisions regulating allotment, particularly Sections 39 and 40, along with provisions relating to private placement and further issue of share capital.

2. Meaning of Allotment of Shares

The Companies Act, 2013 does not provide an exhaustive definition of the word “allotment.”

In simple terms:

Allotment is the appropriation or allocation of a certain number of shares to a particular applicant in response to an application for shares.

It is the process by which the company accepts an applicant's offer to subscribe for shares and creates a binding relationship between the company and the applicant.

Example

A company invites applications for 1,00,000 shares.

Mr. A applies for 5,000 shares.

The company decides to issue 3,000 shares to him.

The appropriation of those 3,000 shares to Mr. A constitutes allotment.

3. Important Statutory Provisions

For examination, remember:

Section	Provision
Section 39	Allotment of securities by company
Section 40	Securities to be dealt with in stock exchanges
Section 42	Private placement
Section 62	Further issue of share capital
Section 56	Transfer and transmission of securities
Section 64	Notice to Registrar regarding alteration of share capital

The principal statutory provision directly dealing with allotment is Section 39.

4. Essentials / Conditions of a Valid Allotment

A valid allotment should satisfy the following requirements.

1. Allotment Must Be Made by Proper Authority

The allotment must be made by the Board of Directors or the duly authorised authority in accordance with the Companies Act and the Articles of Association.

The decision must be properly recorded.

2. Minimum Subscription Must Be Received

Under Section 39(1), where securities are offered to the public, the company cannot make an allotment unless:

1. the minimum amount stated in the prospectus has been subscribed; and

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2. the application money payable for that minimum amount has been received by the company.

Example

If the prospectus states that the minimum subscription is ₹50 lakh, the company cannot proceed with allotment unless that statutory requirement is satisfied.

5. Application Money

Under Section 39(2), the amount payable on application for every security cannot be less than 5% of the nominal amount of the security, or such other percentage/amount as SEBI may specify by regulations.

Therefore, in an examination answer, write:

Section 39(2) prescribes a minimum application money requirement, subject to the percentage or amount specified by SEBI.

6. Refund Where Minimum Subscription Is Not Received

Under Section 39(3), if the minimum amount stated in the prospectus has not been subscribed and the application money is not received within 30 days from the date of issue of the prospectus, or such other period as SEBI may specify, the money received must be returned within the prescribed time and manner.

Thus, investors are protected from the company retaining application money when the required minimum subscription has not been achieved.

7. Return of Allotment

This is a very important examination point.

Under Section 39(4):

Whenever a company having share capital makes any allotment of securities, it must file a return of allotment with the Registrar of Companies in the prescribed manner.

The prescribed filing requirements are governed by the Companies Act and applicable rules.

Importance

The return provides the Registrar with details regarding the securities allotted by the company.

8. Penalty for Default

Under Section 39(5), failure to comply with the requirements relating to refund under Section 39(3) or filing of return of allotment under Section 39(4) attracts statutory penalty.

The company and officer in default may be liable to:

₹1,000 for every day during which the default continues, or ₹1 lakh, whichever is less.

9. Allotment and Stock Exchange — Section 40

Where a company makes a public offer, Section 40 requires the company, before making the offer, to apply to one or more recognised stock exchanges and obtain permission for the securities to be dealt with on such stock exchange(s).

The prospectus must state the name or names of the stock exchange(s) where the securities are proposed to be dealt with.

10. Application Money to Be Kept in Separate Bank Account

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Under Section 40(3), money received from the public on application for securities must be kept in a separate bank account in a scheduled bank.
It cannot be used for general purposes.
It may be used only for:

1. adjustment against allotment where the securities are permitted to be dealt with on the specified stock exchange; or
2. repayment to applicants where the company is unable to allot the securities.

This provision is intended to protect investors' money.
11. Allotment Must Be Properly Communicated
Once the company makes an allotment, the allotment should be communicated to the applicants.
The communication may take the form of an allotment letter or other appropriate electronic communication.
After allotment, the subscriber becomes a member subject to the applicable statutory requirements and the company's records.
12. Allotment Must Be Made in Good Faith
The directors must exercise their powers honestly and for a proper purpose.
They should not use allotment as a device to:

- manipulate control of the company;
- discriminate improperly between shareholders;
- defeat statutory rights; or
- benefit themselves improperly.

The allotment power is a fiduciary power and must be exercised for the benefit of the company.
13. Allotment in Private Placement
Section 42 contains separate rules for private placement.
Important requirements include:

- the offer is made to identified persons;
- subscription money must be paid through permitted banking channels and not in cash;
- public advertisements and general marketing channels cannot be used for the private placement;
- securities must be allotted within the statutory period;
- the company must file the return of allotment with the Registrar.

Under Section 42(6), the company must allot the securities within 60 days from receipt of application money. If it cannot do so, the money must be repaid within the prescribed further period; failure to repay attracts 12% interest from expiry of the 60-day period.
14. Further Issue of Shares — Section 62
Allotment is also relevant when a company makes a further issue of share capital.

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Under Section 62, where a company proposes to increase its subscribed capital by issuing further shares, the shares are generally first offered to existing equity shareholders in proportion to their paid-up shareholding.

This is called a rights issue.

The law also recognises other modes of further issue, subject to statutory conditions.

15. Principle of Proper Authority

The Articles of Association generally confer power on the Board to make allotments.

Therefore, the allotment should be:

- authorised;
- properly resolved;
- within the company's powers;
- made in accordance with the Articles;
- compliant with the Companies Act;
- compliant with applicable SEBI regulations where applicable.

16. Consequences of Irregular Allotment

An allotment made in violation of statutory requirements may expose the company and officers to:

- refund obligations;
- penalties;
- regulatory action;
- claims by affected persons;
- consequences under applicable securities laws.

Therefore, statutory compliance is essential before and after allotment.

17. Important Case Law

⭐ 1. Sri Gopal Jalan & Co. v. Calcutta Stock Exchange Association Ltd.

The Supreme Court explained the nature of allotment and recognised the concept of appropriation of shares out of the unappropriated capital of the company to a particular person.

This is a useful Indian authority for the meaning of allotment.

⭐ 2. N. V. R. Nagappa Chettiar v. Madras Race Club

The case is useful in understanding principles relating to allotment and corporate shares.

For the examination, Sri Gopal Jalan & Co. is the most useful case to remember for the basic concept of allotment.

18. Difference Between Application and Allotment

Application	Allotment
Applicant makes an offer to subscribe	Company accepts/appropriates shares
It precedes allotment	It follows application

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Application	Allotment
Applicant seeks shares	Company decides the number of shares to issue
No specific shares are necessarily appropriated yet	Specific shares are appropriated to the applicant
It is generally an offer	It constitutes acceptance, subject to applicable law

19. Difference Between Allotment and Transfer

Allotment	Transfer
Shares are issued by the company	Existing shares move from one person to another
It concerns unissued capital	It concerns already issued shares
Creates membership interest in the original issue	Transfers an existing membership interest
Governed principally by issue/allotment provisions	Governed principally by Section 56 and Articles

20. Simple Flow Chart

Public Issue
↓
Application for Shares
↓
Minimum Subscription Satisfied
↓
Application Money Received
↓
Board considers applications
↓
Allotment of Shares
↓
Allotment Communication
↓
File Return of Allotment with ROC
↓
Issue/record securities in accordance with law

21. Conclusion

Allotment of shares is the process by which a company appropriates a specified number of shares to an applicant pursuant to an application for shares.

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The Companies Act, 2013 provides safeguards to ensure that allotment is not made arbitrarily. Section 39 imposes important conditions relating to minimum subscription, application money, refund and filing of return of allotment, while Section 40 protects public investors in relation to stock-exchange requirements and application money.
Therefore, allotment is not merely an internal decision of directors; it is a statutory process subject to the Companies Act, applicable rules and, where relevant, SEBI regulations.

⭐ Exam Revision

Remember this sequence:
Section 39 → Allotment
Minimum subscription → Section 39(1)
Application money → Section 39(2)
Refund → Section 39(3)
Return of allotment → Section 39(4)
Penalty → Section 39(5)
Stock exchange → Section 40
Private placement → Section 42
Further issue/Rights issue → Section 62
Case → Sri Gopal Jalan & Co.
One-line conclusion:
"Allotment is the appropriation of shares to a particular applicant, and its validity depends upon compliance with the Companies Act, the Articles of Association and applicable securities regulations."

QUESTION 6

What do you mean by Private Company? Under what circumstances does a Private Company become a Public Company?

1. Introduction

The Companies Act, 2013 recognises both private companies and public companies as important forms of corporate organisation.
A private company is generally formed for closely held business activities, whereas a public company is designed for a wider ownership structure and, subject to law, may invite the public to subscribe to its securities.
The principal provisions are contained in Sections 2(68), 2(71), 13 and 14 of the Companies Act, 2013.

2. Definition of Private Company

Section 2(68) of the Companies Act, 2013 defines a private company as a company which, by its Articles:
(a)restricts the right to transfer its shares;
(b)except in the case of an OPC, limits the number of its members to 200; and
(c)prohibits any invitation to the public to subscribe for any securities of the company.

Thus, these three characteristics form the core definition of a private company.
(indiacode.nic.in)
3. Meaning in Simple Words
A private company is essentially a closely held company in which:
Transfer of shares is restricted

- Membership is restricted
- Public invitation for securities is prohibited= Private Company

4. Minimum Number of Members
A private company, other than an OPC, generally requires a minimum of two members.
An OPC can have only one member.
5. Minimum Number of Directors
Under Section 149(1), a private company must have at least two directors.
An OPC requires at least one director.
A public company requires at least three directors.
6. Maximum Number of Members
A private company generally cannot have more than 200 members, subject to the exclusions specified in Section 2(68).
For example, persons who are:

- employees of the company; and
- were members while being employees,

may be excluded in accordance with the statutory definition.
7. Important Characteristics of a Private Company
1. Restriction on Transfer of Shares
The Articles must restrict the right to transfer shares.
However, this does not necessarily mean that shares can never be transferred.
It means that the transfer is subject to restrictions contained in the Articles.
2. Restriction on Membership
Except for an OPC, the number of members is limited to 200, subject to statutory exclusions.
3. No Public Invitation
A private company cannot invite the public to subscribe for its securities.
This is one of the most important distinctions between a private and public company.
4. Name
A private company normally uses the word:
“Private Limited”
at the end of its name.
For example:
ABC Technologies Private Limited
8. Privileges of Private Companies
The Companies Act gives certain exemptions and relaxations to private companies, subject to the conditions prescribed by law.

Some important advantages include:

1. No Public Issue

A private company is not permitted to invite the public to subscribe to its securities.

2. Closely Held Management

Ownership and management can remain within a limited group.

3. Greater Flexibility

Private companies enjoy certain statutory exemptions and procedural relaxations compared with public companies, depending on the applicable provisions and rules.

4. No Requirement of Minimum Subscription for Public Issue

The statutory minimum-subscription regime applicable to public offers is not applicable in the same manner because a private company cannot make a public offer.

5. Restrictions on Transfer

The restrictions on share transfers help maintain control within the existing members.

9. What is a Public Company?

Section 2(71) defines a public company as a company which:

- is not a private company; and
- has a minimum prescribed paid-up share capital, subject to the statutory framework.

A public company generally requires at least seven members and at least three directors.

10. Conversion of Private Company into Public Company

A private company can voluntarily become a public company.

The principal provision is Section 14 of the Companies Act, 2013.

A company may alter its Articles so as to remove the restrictions applicable to a private company and become a public company, subject to the statutory procedure.

(indiacode.nic.in)

11. Circumstances in Which a Private Company Becomes a Public Company

There are several situations in which a private company may cease to be a private company.

A. Voluntary Conversion

The company may voluntarily convert itself into a public company.

Procedure broadly involves:

1. Board meeting;
2. decision to convert;
3. alteration of Articles;
4. alteration of name where required;
5. passing the necessary special resolution;
6. increasing the number of members/directors if required;
7. filing the prescribed forms and documents with the Registrar;
8. obtaining the necessary certificate/updated registration status.

12. Conversion by Alteration of Articles

Section 14 is particularly important.

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Where the Articles of a private company are altered in such a manner that they no longer contain the restrictions required for a private company, the company ceases to be a private company from the date of alteration.

The company must then comply with the requirements applicable to a public company. (indiacode.nic.in)

13. Conversion When Statutory Conditions Are Violated

A private company may also lose its private-company status where it ceases to satisfy the statutory requirements of a private company.

For example, if its Articles no longer contain the essential restrictions required under Section 2(68), it cannot continue to claim private-company status.

14. Conversion Through Default in Compliance

The Companies Act provides consequences where a company fails to comply with statutory requirements.

The Registrar and other authorities may take action in accordance with the Act and applicable rules.

Therefore, a company cannot simply continue to describe itself as a private company if it no longer satisfies the statutory definition.

15. Special Situation — Private Company Becoming a Public Company by Law

Section 43 and other provisions of the Companies Act must also be considered in relation to the rights and classes of securities.

However, for this question, the most important statutory mechanism is Section 14 — alteration of Articles and conversion.

16. Effect of Conversion

Once a private company becomes a public company:

1. Name changes

The word “Private” is removed from the company's name.

Example:

ABC Technologies Private Limited

becomes:

ABC Technologies Limited

2. Public company provisions apply

The company becomes subject to the provisions applicable to public companies.

3. Shareholding structure

The restrictions applicable specifically to private companies cease to operate to the extent they were removed through conversion.

4. Directors

The company must comply with the requirements applicable to public companies, including the requirement of at least three directors.

5. Members

The company must satisfy the membership requirements applicable to a public company.

6. Public issue

After conversion, the company becomes legally capable of making a public offer, but conversion itself does not automatically constitute a public issue. Any public issue must separately comply with the Companies Act, SEBI regulations and other applicable securities laws.

17. Private Company vs Public Company

Basis	Private Company	Public Company
Section	2(68)	2(71)
Minimum members	2, except OPC	7
Maximum members	Generally 200	No such maximum
Minimum directors	2	3
Transfer of shares	Restricted	Generally freely transferable, subject to law
Public invitation	Prohibited	Permitted subject to law
Name	“Private Limited”	“Limited”
Ownership	Closely held	Wider ownership possible
Compliance	Certain exemptions/relaxations	Generally greater compliance

18. Important Case Law

Madan Gopal v. Kalinga Tubes Ltd.

The case is useful for understanding the distinction between private and public company characteristics and the significance of statutory requirements.

For examination purposes, however, the statutory provisions are more important than case law for this particular question.

19. Examination Flow Chart

Private Company

Section 2(68)

↓

Restriction on transfer

↓

Maximum 200 members

↓

No invitation to public

↓

Conversion

Board approval

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↓

Alter Articles

↓

Special Resolution

↓

File prescribed documents with ROC

↓

Comply with public-company requirements

↓

Public Company

20. Conclusion

A private company is a closely held corporate entity characterised by restriction on transfer of shares, limitation on membership and prohibition of invitation to the public to subscribe to its securities.

Under Section 14, a private company may voluntarily convert itself into a public company by altering its Articles in accordance with the Companies Act and following the prescribed procedure. Once the Articles cease to contain the essential characteristics of a private company, the company ceases to be a private company and must comply with the provisions applicable to public companies. (indiacode.nic.in)

⭐ Must Remember for Exam

Section 2(68) → Private Company

Section 2(71) → Public Company

Section 14 → Alteration of Articles / Conversion

Private Company → Restriction + 200 members + No public invitation

Minimum members → Private: 2 | Public: 7

Minimum directors → Private: 2 | Public: 3

One-line conclusion:

"A private company is a closely held corporate form protected by restrictions on membership, transfer of shares and public invitation; it becomes a public company when it voluntarily or otherwise ceases to satisfy the statutory requirements of a private company and complies with the conversion provisions of the Companies Act, 2013."

QUESTION 7

"Company is an artificial person, invisible, intangible and existing only in the eye of law." — Discuss.

1. Introduction

A company is not a natural human being. It is a juristic or artificial person created by law. It has no physical body or natural existence, but after incorporation the law recognises it as a separate legal entity.

The famous statement of Chief Justice Marshall in *Trustees of Dartmouth College v. Woodward* describes a corporation as an artificial being, invisible, intangible and existing only in contemplation of law.

The most important principle associated with corporate personality is the doctrine of separate legal personality.

2. Meaning of Artificial Legal Person

A company is called an artificial person because:

- it is created by law;
- it has no physical body;
- it cannot act physically by itself;
- it acts through its directors, officers and authorised agents;
- it can own property;
- it can enter into contracts;
- it can sue and be sued;
- it can incur debts and liabilities.

Thus, although the company is not a human being, the law treats it as a legal person for corporate purposes.

3. Statutory Recognition

Section 9 of the Companies Act, 2013 provides that from the date of incorporation mentioned in the certificate of incorporation, the subscribers and other persons constituting the company become a body corporate capable of exercising the functions of an incorporated company.

It has:

- perpetual succession;
- power to acquire, hold and dispose of property;
- power to contract;
- power to sue and be sued in its own name.

This statutory recognition is the foundation of corporate personality.

4. Separate Legal Entity

The most important consequence of incorporation is that the company becomes legally separate from its members.

Example

Suppose A, B and C form XYZ Ltd.

Even though A, B and C own all the shares, the law treats:

A + B + C ≠ XYZ Ltd.

The company has a separate legal identity.

Therefore:

- company property is not automatically shareholders' property;
- company debts are not automatically shareholders' personal debts;
- contracts entered into by the company are corporate contracts.

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5. Leading Case — Salomon v. Salomon & Co. Ltd.

⭐ Most Important Case

Salomon v. A. Salomon & Co. Ltd. (1897)

Facts

Mr. Salomon carried on a boot-making business as a sole proprietor.

He incorporated a company in accordance with the law. His family members became shareholders so that the statutory requirements for incorporation were satisfied.

The company subsequently became insolvent.

The creditors argued that Mr. Salomon and the company were essentially the same person.

Decision

The House of Lords rejected this argument.

It held that once the company was properly incorporated, it became a separate legal person distinct from Mr. Salomon and its shareholders.

Principle

Incorporation creates a legal personality separate from the members.

This is known as the Salomon principle.

6. Consequences of Separate Legal Personality

1. Company Owns Its Own Property

Company property belongs to the company and not to individual shareholders.

Case:

Macaura v. Northern Assurance Co. Ltd. (1925)

A shareholder could not treat company property as his personal property merely because he owned virtually all the company's shares.

7. Company Can Sue and Be Sued

A company can institute proceedings in its own name.

Similarly, legal proceedings can be brought against the company.

The company's cause of action is distinct from the personal cause of action of its shareholders.

8. Company Can Enter into Contracts

A company can enter into contracts through its authorised directors or officers.

The contract is between:

Company ↔ Other Contracting Party

and not ordinarily:

Shareholder ↔ Other Contracting Party

9. Limited Liability

Where a company is limited by shares, members' liability is ordinarily limited to the amount unpaid on their shares.

Example

If a shareholder has subscribed for shares worth ₹1,00,000 and has already paid ₹80,000, the normal unpaid liability is ₹20,000.

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Therefore, the company's creditors generally cannot directly claim the shareholder's personal assets merely because the company owes money.

10. Perpetual Succession

A company has perpetual succession.

The death, insolvency or retirement of a shareholder does not normally terminate the company's existence.

Thus:

Members may change, but the company continues.

11. Company Property Is Different from Members' Property

This principle was strongly recognised in Macaura v. Northern Assurance Co. Ltd.

Even a person holding almost all shares does not own the company's assets personally.

The company is the legal owner.

12. Company Is Not the Agent of Shareholders

Shareholders are not ordinarily personally liable for every transaction undertaken by the company.

The company acts through its authorised agents, particularly its directors and officers.

The shareholders are therefore not automatically principals for every corporate transaction.

13. Company Can Borrow Money

Because the company has a separate legal personality, it can:

- borrow money;
- create security;
- issue debentures;
- own assets;
- undertake commercial obligations.

The liability ordinarily belongs to the company.

14. Company Can Commit Torts

A company may incur civil liability for wrongful acts committed by its officers or employees in the course of company business, subject to applicable legal principles.

Thus, corporate personality does not mean that the company is immune from legal liability.

15. Company Can Commit Criminal Offences

A company can also be prosecuted for offences where the applicable statute permits corporate criminal liability.

The fact that the company is an artificial person does not automatically provide immunity from criminal proceedings.

16. Separate Corporate Personality and Group Companies

A holding company and subsidiary company are generally treated as separate legal entities.

Ownership or control by the holding company does not automatically eliminate the separate personality of the subsidiary.

Each company normally has its own:

- assets;

- liabilities;
- contracts;
- legal identity.

However, courts may disregard this separation in exceptional circumstances.

17. Lifting or Piercing the Corporate Veil

The corporate veil is the legal separation between:

Company

and

Members / Directors / Controllers

Ordinarily, courts respect this separation.

However, in exceptional circumstances, courts may lift or pierce the corporate veil to determine the persons actually behind the company or to prevent misuse of the corporate form.

18. Circumstances for Lifting the Corporate Veil

1. Fraud or Improper Conduct

Where the corporate structure is used as a device for fraud, courts may disregard the separate personality.

2. Evasion of Legal Obligations

A company cannot ordinarily be used merely as a device to evade an existing legal obligation.

Case:

Gilford Motor Co. Ltd. v. Horne

A company was used to circumvent a contractual restriction.

The court was prepared to look behind the corporate structure.

19. Company Used as a Sham or Façade

Where incorporation is merely a sham or façade concealing the true facts, the court may examine the reality behind the structure.

Case:

Jones v. Lipman

A company was used to avoid enforcement of a contractual obligation concerning property.

The court treated the company as a device to evade the obligation.

20. Protection of Public Interest

In exceptional situations, particularly where public interest or statutory obligations require it, courts may examine the persons behind the company.

21. Enemy Character

During wartime, courts have historically examined the persons controlling a company to determine whether it has an enemy character.

Case:

Daimler Co. Ltd. v. Continental Tyre and Rubber Co. (Great Britain) Ltd.

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The court considered the nationality/control of persons behind the company in the wartime context.

22. Tax Evasion

Where corporate structures are used for improper tax evasion or to defeat tax law, courts and authorities may examine the substance of the arrangement.

However, legitimate tax planning and lawful corporate structuring should not automatically be treated as tax evasion.

23. Statutory Provisions Permitting Veil-Lifting

The Companies Act, 2013 itself contains provisions that impose personal consequences upon directors or officers in specified circumstances.

Examples include provisions relating to:

- fraud;
- misrepresentation;
- fraudulent conduct of business;
- personal liability in specified circumstances.

Therefore, separate corporate personality is a general principle, not an absolute immunity.

24. Important Indian Case — LIC v. Escorts Ltd.

Life Insurance Corporation of India v. Escorts Ltd.

The Supreme Court discussed circumstances in which the corporate veil may be lifted.

The Court recognised that the veil may be lifted where:

- statute requires it;
- fraud or improper conduct is involved;
- tax or regulatory obligations are being evaded;
- associated companies are being used in a manner requiring examination of the real situation.

This is an important Indian authority for the doctrine.

25. Separate Legal Personality vs Corporate Veil

Separate Legal Personality	Corporate Veil
Company is a separate legal person	Legal separation between company and members
Established on incorporation	Protects corporate personality
Company owns its assets	Members do not ordinarily own corporate assets
Company has its own liabilities	Members normally have limited liability
Salomon is the leading case	Veil may be lifted in exceptional cases

26. “Artificial Person” Does Not Mean “Fictitious Person”

It is important to understand this distinction.

A company is artificial, but it is not legally meaningless.

The law gives it real legal rights and obligations.

It can:

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- own property;
- enter contracts;
- borrow money;
- employ persons;
- sue;
- be sued;
- incur liabilities;
- exercise statutory rights.

Therefore, its personality is artificial in origin but real in legal effect.

27. Why Is a Company Called Invisible and Intangible?

A natural person has:

- body;
- physical existence;
- biological identity.

A company does not have these.

Its existence is recognised through:

- certificate of incorporation;
- Memorandum;
- Articles;
- statutory records;
- corporate decisions;
- authorised representatives.

Therefore, it is described as:

“Invisible, intangible and existing only in the contemplation of law.”

28. Exam-Oriented Diagram

INCORPORATION

↓

COMPANY BECOMES BODY CORPORATE

↓

SEPARATE LEGAL PERSONALITY

↓

Company's property ≠ Members' property

Company's debts ≠ Members' debts

Company's contracts ≠ Members' contracts

Company continues despite change of members

↓

EXCEPTIONAL CASES

↓

Corporate Veil May Be Lifted

↓

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Fraud / Sham / Evasion / Statutory requirement / Public interest etc.

29. Important Cases to Remember

⭐ 1. Salomon v. Salomon & Co. Ltd. (1897)

Separate legal personality

⭐ 2. Lee v. Lee's Air Farming Ltd. (1961)

A person can have a separate legal relationship with the company even while controlling it.

⭐ 3. Macaura v. Northern Assurance Co. Ltd. (1925)

Company property belongs to the company.

⭐ 4. Gilford Motor Co. Ltd. v. Horne

Corporate structure used to evade contractual obligations.

⭐ 5. Jones v. Lipman

Company used as a façade to avoid legal obligation.

⭐ 6. LIC v. Escorts Ltd.

Important Indian authority concerning lifting of corporate veil.

⭐ 7. Daimler Co. Ltd. v. Continental Tyre

Enemy character and corporate control.

30. Conclusion

A company is rightly described as an artificial, invisible and intangible legal person because it has no physical existence like a human being, yet the law recognises it as a distinct juristic entity.

The doctrine of separate legal personality, firmly established in Salomon v. Salomon & Co. Ltd., gives a company its independent legal identity. It enables the company to own property, enter contracts, incur liabilities, sue and be sued and enjoy perpetual succession. However, separate personality cannot be used as a shield for fraud, evasion of law or improper conduct. Therefore, in exceptional circumstances, courts may lift the corporate veil.

⭐ Best examination conclusion

“Corporate personality is the foundation of modern company law. The company is a legal person distinct from its members, but the corporate veil is not an absolute protection where the corporate form is misused for fraud, evasion of law or other improper purposes.”

🔑 Quick Revision

Section 9 → Body Corporate

Salomon → Separate Legal Entity

Macaura → Company Property

Lee → Separate legal relationships

Gilford Motor → Evasion

Jones v. Lipman → Sham/Façade

LIC v. Escorts → Lifting of Corporate Veil

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QUESTION 8

Explain the Procedure for Registration of a Foreign Company in India

1. Introduction

In the era of globalisation, foreign companies frequently establish business operations in India. The Companies Act, 2013 provides a statutory framework governing foreign companies carrying on business in India.

The principal provisions are contained in Sections 2(42) and 380 to 386 of the Companies Act, 2013, along with the Companies (Registration of Foreign Companies) Rules, 2014.

2. Meaning of Foreign Company

Section 2(42) of the Companies Act, 2013 defines a foreign company as any company or body corporate incorporated outside India which:

1. has a place of business in India, whether by itself or through an agent, physically or through electronic mode; and
2. conducts any business activity in India in any other manner.

Thus, two important elements are:

Incorporated outside India

•

Place of business/business activity in India

= Foreign Company

3. Applicability of Foreign Company Provisions

A foreign company carrying on business in India has to comply with the requirements of Chapter XXII of the Companies Act, 2013, particularly Sections 380–386.

The law seeks to ensure:

- transparency;
- disclosure;
- accountability;
- protection of Indian stakeholders;
- regulatory supervision.

4. Registration — Section 380

Section 380 is the principal provision dealing with documents to be delivered to the Registrar by a foreign company.

Every foreign company must, within 30 days of establishing its place of business in India, deliver the prescribed documents and particulars to the Registrar.

5. Documents to be Filed

The important documents include the following.

1. Certified Copy of Charter Documents

The company must submit a certified copy of its:

- charter;
- statutes;
- memorandum and articles; or

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- other constitutional documents.

These documents establish the legal constitution of the foreign company.

2. Registered Office Details

The foreign company must provide details of its registered/principal office in the foreign country.

3. Details of Directors and Secretary

Particulars of the directors and secretary of the foreign company must be furnished in the prescribed manner.

This enables Indian authorities to identify the persons responsible for management.

4. Details of Authorised Person in India

The foreign company must provide details of the person or persons resident in India who are authorised to accept notices and other documents on behalf of the company.

This is particularly important for service of legal and regulatory documents in India.

5. Details of Indian Office

The foreign company must provide particulars of:

- principal place of business in India;
- other places of business in India, if any.

6. Details of Opening and Closing of Financial Year

The company must provide prescribed information regarding its financial year.

7. Details of Previous Registration in India

Where applicable, information concerning previous registration or business operations in India has to be disclosed.

8. Declaration Regarding Directors

Prescribed declarations regarding directors and other particulars must be submitted.

6. Filing with Registrar of Companies

The prescribed documents are filed electronically with the Registrar of Companies (ROC) through the MCA system.

The relevant forms and filing requirements are governed by the Companies Act and the Companies (Registration of Foreign Companies) Rules, 2014.

For examination purposes, remember:

Foreign company → Establish place of business → File prescribed documents with ROC within 30 days.

7. Registration of Foreign Company Through Electronic Mode

The definition of foreign company expressly recognises a place of business in India whether physical or through electronic mode.

Therefore, modern forms of digital/e-commerce business can also fall within the regulatory framework where the statutory conditions are satisfied.

This is particularly significant in the context of:

- e-commerce;
- online services;

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- digital platforms;
- electronic business operations.

8. Accounts of Foreign Company — Section 381

Every foreign company must prepare financial statements relating to its Indian business operations and comply with the statutory requirements regarding filing of accounts.

Section 381 requires prescribed financial statements and related documents to be delivered to the Registrar.

The documents generally include:

- financial statements;
- related documents;
- list of places of business in India;
- other prescribed particulars.

9. Display of Name and Country of Incorporation — Section 382

Every foreign company must prominently display outside every office or place of business in India:

- its name; and
- the country in which it was incorporated.

The company's name and country of incorporation must also be appropriately disclosed on business documents as required by law.

Purpose

This provision protects Indian customers and stakeholders by making it clear that they are dealing with a foreign incorporated entity.

10. Service of Documents — Section 383

A foreign company must have arrangements for receiving notices and other documents in India.

The person authorised to accept service in India acts as the contact point for statutory and legal communications.

11. Registration of Charges — Section 384

The provisions relating to registration of charges may apply to foreign companies in accordance with the Companies Act.

Thus, where a foreign company creates a charge over property or assets in India, applicable statutory requirements relating to registration of charges must be followed.

12. Applicability of Other Provisions — Section 385

Section 385 provides for application of certain provisions of the Companies Act to foreign companies.

Therefore, a foreign company cannot assume that only Section 380 applies to it.

It must comply with the provisions specifically made applicable to foreign companies under the Act.

13. Punishment for Contravention — Section 392

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Section 392 provides consequences for contravention of the provisions relating to foreign companies.

Where a foreign company contravenes the provisions of Chapter XXII, the company and officers in default may be subject to the prescribed penalties.

Therefore, registration and continuing compliance are essential.

14. Step-by-Step Procedure

For an LL.M. examination, the entire procedure can be remembered as follows:

STEP 1 — Incorporation Abroad

The entity must first be incorporated under the law of a foreign country.

↓

STEP 2 — Establish Business Presence in India

It establishes a place of business or carries on business activity in India in accordance with Section 2(42).

↓

STEP 3 — Appoint Authorised Person in India

The company identifies a person resident in India authorised to receive notices/documents.

↓

STEP 4 — Prepare Constitutional Documents

Prepare certified copies of:

- charter;
- statutes;
- memorandum;
- articles;
- certificate of incorporation;
- other prescribed documents.

↓

STEP 5 — Provide Directors' Particulars

Details of directors and secretary are prepared.

↓

STEP 6 — Provide Indian Office Details

Details of the principal place of business and other places of business in India are furnished.

↓

STEP 7 — File with ROC

The prescribed documents and particulars are filed electronically with the Registrar.

↓

STEP 8 — ROC Registration/Record

The Registrar records the prescribed particulars and the foreign company becomes subject to the applicable provisions of the Companies Act.

↓

STEP 9 — Continuing Compliance

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The foreign company must thereafter comply with applicable requirements relating to:

- accounts;
- annual filings;
- display of name;
- service of documents;
- charges;
- financial statements;
- other statutory disclosures.

15. Important Documents — Quick Revision

Remember:

C → Charter documents

D → Directors

S → Secretary

A → Authorised person in India

O → Office/place of business in India

F → Financial information

R → Registrar filing

A useful examination sentence is:

“The foreign company is required to disclose its constitutional documents, particulars of directors and secretary, details of its principal place of business in India and the particulars of the person authorised to receive notices in India.”

16. Foreign Company vs Indian Subsidiary

A foreign company carrying on business in India should be distinguished from an Indian company incorporated as a subsidiary of a foreign company.

Foreign Company

- incorporated outside India;
- establishes a place of business/carries on business activity in India;
- governed by the foreign company's constitutional law as well as applicable Indian requirements.

Indian Subsidiary

- incorporated in India;
- is a separate Indian company;
- may be controlled by a foreign holding company;
- governed principally by the Companies Act, 2013 and other applicable Indian laws.

17. Importance of Registration

Registration and disclosure requirements are important because they:

1. Protect Indian stakeholders

Indian customers, employees, creditors and investors can identify the foreign entity.

2. Ensure transparency

The government receives information about foreign business operations.

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3. Facilitate legal proceedings

There is a known person/place in India for service of documents.

4. Promote regulatory compliance

The foreign company becomes subject to applicable Indian corporate requirements.

5. Prevent misuse

Disclosure requirements help prevent foreign corporate structures from being used for unlawful activities.

18. Important Statutory Provisions

For the examination, remember this sequence:

Section	Subject
2(42)	Definition of Foreign Company
380	Documents to be delivered to Registrar
381	Accounts of Foreign Company
382	Display of name
383	Service of documents
384	Registration of charges
385	Application of provisions
386	Interpretation
392	Punishment for contravention

19. Case Law

For this question, statutory provisions are more important than case law because the question specifically asks about the registration procedure.

However, you can mention the general principle that a foreign incorporated entity carrying on business in India is subject to Indian regulatory requirements concerning its Indian operations.

The best scoring approach is therefore to concentrate on Sections 2(42), 380–386 and 392.

20. Conclusion

The Companies Act, 2013 provides a comprehensive regulatory framework for foreign companies carrying on business in India. A foreign company covered by Section 2(42) must comply with Section 380 by delivering the prescribed documents and particulars to the Registrar within the statutory period after establishing its place of business in India. It must thereafter comply with continuing requirements relating to accounts, disclosures, service of documents, charges and other applicable provisions.

⭐ Best Exam Conclusion

“The registration of a foreign company in India is essentially a process of statutory disclosure and regulatory recognition. Sections 2(42) and 380–386 of the Companies Act, 2013 ensure

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that a foreign entity carrying on business in India remains transparent and accountable to Indian law and stakeholders."

🔥 FINAL REVISION — ALL 8 QUESTIONS

You now have all 8 questions from this April/May 2024 LL.M. General Principles of Company Law paper:

1. Company — kinds and advantages of incorporation
2. Promoter — duties and liabilities
3. Prospectus — contents and remedies for misrepresentation
4. Doctrine of Ultra Vires
5. Allotment of Shares — statutory rules
6. Private Company — conversion into Public Company
7. Artificial Legal Person — separate legal personality
8. Registration of Foreign Company in India

QUESTION 2 — 2019

What is a Share? Give a Detailed Account of the Kinds of Shares and the Rights of Each Class of Shareholders

1. Introduction

The capital of a company limited by shares is divided into units known as **shares**. A share represents the member's interest in the share capital of the company and carries certain rights and liabilities.

Under **Section 2(84) of the Companies Act, 2013**, "share" means a share in the share capital of a company and includes stock.

A share is a unit of the share capital of a company representing the interest of a member in the company.

2. Nature of a Share

A share has the following characteristics:

1. It represents an interest in the company.
2. It is movable property.
3. It carries rights and liabilities.
4. It is generally transferable subject to the Articles and the Companies Act.
5. It may carry voting and dividend rights.
6. The rights attached to a share depend upon its class and terms of issue.

Section 44

Under **Section 44**, shares or other interest of a member in a company are movable property and are transferable in the manner provided by the company's Articles.

3. Kinds of Shares — Section 43

Section **43** provides that the share capital of a company limited by shares consists of two kinds:

1. Equity Share Capital

2. Preference Share Capital

4. Equity Shares

Equity shares are ordinary shares which generally carry voting rights and participate in the residual profits and assets of the company.

Section 43 recognises:

A. Equity shares with voting rights

These shareholders normally have voting rights in company meetings.

B. Equity shares with differential rights

A company may issue equity shares having differential rights as to:

- dividend;
- voting; or
- otherwise,

subject to the Companies Act and applicable rules.

5. Rights of Equity Shareholders

1. Right to Vote

Under **Section 47**, equity shareholders have the right to vote on resolutions placed before the company, subject to the Act.

2. Right to Dividend

They are entitled to participate in dividend when dividend is declared, subject to the company's profits and applicable law.

3. Right to Participate in Surplus

On winding up, after satisfaction of preferential claims and liabilities, equity shareholders participate in the remaining surplus according to their rights.

4. Right to Receive Notices

They have the right to receive notices of general meetings and participate in them.

5. Right to Participate in Management

Through voting, equity shareholders can participate indirectly in corporate management, including election of directors where applicable.

6. Right to Inspect Certain Documents

Members have statutory rights to inspect specified corporate records and documents.

7. Right to Transfer Shares

Subject to the Articles and applicable law, equity shares are transferable.

6. Preference Shares

Preference shares are shares carrying preferential rights concerning:

1. **payment of dividend**, and
2. **repayment of capital**,

in preference to equity shareholders.

This is the statutory concept under **Section 43**.

7. Types of Preference Shares

Preference shares may be classified according to the rights attached to them.

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A. Cumulative Preference Shares

If dividend is not paid in a particular year, the unpaid dividend generally accumulates and becomes payable in subsequent years, subject to the terms of issue.

B. Non-Cumulative Preference Shares

Unpaid dividend for a particular year generally does not accumulate as arrears, subject to the terms of issue.

C. Participating Preference Shares

These may participate in surplus profits or assets in addition to their preferential rights if the terms of issue provide for such participation.

D. Non-Participating Preference Shares

They receive only the preferential rights specified and do not participate in additional surplus.

E. Convertible Preference Shares

These carry a right to convert into equity shares according to the terms of issue.

F. Non-Convertible Preference Shares

These do not carry a conversion right.

G. Redeemable Preference Shares

These are preference shares issued on terms permitting redemption in accordance with the Companies Act.

8. Rights of Preference Shareholders

1. Preferential Dividend

They have priority over equity shareholders in payment of dividend according to the terms of issue.

2. Preferential Repayment of Capital

On winding up, they have priority over equity shareholders in repayment of capital, subject to the statutory scheme.

3. Voting Rights

Preference shareholders have voting rights in the circumstances provided by **Section 47**. Generally, their voting rights are restricted compared with equity shareholders.

They can vote on resolutions directly affecting their rights and, where dividend remains unpaid for the prescribed period, they acquire the wider voting rights specified by the Act.

4. Right to Receive Notices

They are entitled to notices of meetings in accordance with the Act.

5. Right to Participate Where Terms Permit

Participating preference shareholders may participate in additional surplus where their terms of issue so provide.

9. Equity vs Preference Shares

Basis	**Equity Shares**	**Preference Shares**
Dividend	Generally variable	Preferential dividend

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Basis	Equity Shares	Preference Shares
Voting	Generally full voting rights	Restricted, subject to Section 47
Risk	Higher	Relatively lower due to preference
Repayment	After preference shareholders	Preferential
Return	Not fixed	Generally fixed/preferential
Residual surplus	Generally participate	Only if participating rights exist
Management	Greater participation	Limited

10. Rights of Shareholders — General

Apart from class-specific rights, shareholders may have several general statutory rights.

1. Right to receive share certificate

Subject to statutory requirements.

2. Right to receive notice of meetings

Members are entitled to notice of general meetings.

3. Right to attend meetings

Members can attend and participate subject to law.

4. Right to vote

Voting rights depend upon the class of shares.

5. Right to dividend

Where lawfully declared, shareholders are entitled to dividend according to their rights.

6. Right to transfer shares

Shares are generally transferable subject to applicable restrictions.

7. Right to participate in surplus

Members may participate in surplus assets on winding up according to their respective rights.

8. Right against oppression and mismanagement

Eligible members may seek statutory remedies under the Companies Act where applicable.

11. Important Statutory Sections

Section	Subject
2(84)	Definition of share
43	Kinds of share capital
44	Shares as movable property
46	Share certificate
47	Voting rights
48	Variation of shareholders' rights
55	Issue and redemption of preference shares
56	Transfer and transmission

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Section	Subject
62	Further issue of share capital

12. Variation of Class Rights — Section 48

An important protection for shareholders is contained in **Section 48**.

Where share capital is divided into different classes, rights attached to a class may be varied only in accordance with the statutory requirements.

This protects shareholders against arbitrary alteration of their class rights.

13. Example

Suppose ABC Ltd. has:

10,000 Equity Shares

and

5,000 Preference Shares

The preference shareholders may have:

- priority dividend; and
- priority repayment of capital.

The equity shareholders generally have:

- wider voting rights;
- residual participation in profits;
- residual participation in surplus assets.

Thus, the two classes have different rights because the nature of their shares is different.

14. Important Case

Borland's Trustee v. Steel Brothers & Co. Ltd.

The case is useful for explaining the nature of a share as a bundle of rights and obligations between the shareholder and the company.

The rights attached to a share are determined by:

- the Companies Act;
- Memorandum;
- Articles;
- terms of issue.

15. Conclusion

A share represents the interest of a member in the share capital of a company. Under **Section 43**, share capital is broadly divided into **equity and preference share capital**. Equity shareholders generally bear greater risk and have wider voting rights, while preference shareholders enjoy preferential rights concerning dividend and repayment of capital.

The Companies Act protects the rights of different classes of shareholders through provisions relating to voting, transfer, variation of class rights, dividend and winding up.

⭐ Best examination conclusion

“A share is not merely a unit of money invested in a company; it represents a bundle of legal rights and obligations. The Companies Act, 2013 recognises equity and preference

share capital and provides a statutory framework for protecting the respective rights of each class of shareholders."

🔥 **Quick Revision**

Section 2(84) → Share
Section 43 → Equity + Preference
Section 44 → Movable property
Section 47 → Voting
Section 48 → Variation of class rights
Section 55 → Preference shares
Section 56 → Transfer

QUESTION 4 — 2019

Distinguish Between Memorandum of Association and Articles of Association

1. Introduction

The **Memorandum of Association (MOA)** and **Articles of Association (AOA)** are the two fundamental constitutional documents of a company.

The **MOA** defines the company's **constitution, objects and external limits of its powers**, whereas the **AOA** contains the **rules and regulations for the internal management** of the company.

Under the Companies Act, 2013:

- **Section 2(56)** → Memorandum
- **Section 2(5)** → Articles

2. Memorandum of Association

Section **2(56)** defines "memorandum" as the memorandum of association of a company as originally framed or altered from time to time in pursuance of any previous company law or the Companies Act, 2013.

The MOA is essentially the company's **charter**.

It defines the fundamental conditions on which the company is incorporated.

3. Articles of Association

Section **2(5)** defines "articles" as the articles of association of a company as originally framed or altered from time to time.

The AOA contains the **regulations for management of the company**.

It deals mainly with the company's internal administration.

4. Contents of Memorandum — Section 4

The MOA generally contains:

1. Name Clause

Specifies the name of the company.

2. Registered Office / State Clause

Specifies the State in which the registered office of the company is situated.

3. Objects Clause

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States the objects for which the company is incorporated and matters necessary in furtherance thereof.

4. Liability Clause

States whether the liability of members is limited or unlimited and, where applicable, the extent of liability.

5. Capital Clause

Specifies the authorised share capital and its division into shares, where the company has share capital.

6. Subscription Clause

Contains the declaration/subscription by the persons agreeing to form the company.

5. Contents of Articles — Section 5

The AOA contains regulations concerning the company's internal management.

It may deal with:

- share capital;
- calls on shares;
- transfer and transmission of shares;
- forfeiture;
- alteration of capital;
- meetings;
- voting;
- appointment of directors;
- proceedings of directors;
- dividends;
- accounts;
- borrowing powers;
- common seal, where applicable;
- winding up;
- other internal matters.

6. Difference Between MOA and AOA

This is the **most important part of the answer**.

Basis	**Memorandum of Association**	**Articles of Association**
Nature	Charter of the company	Internal rule book
Section	Section 2(56)	Section 2(5)
Main provision	Section 4	Section 5
Purpose	Defines constitution and objects	Regulates internal management
Scope	External relationship and fundamental powers	Internal administration

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Basis	Memorandum of Association	Articles of Association
Objects	Contains objects clause	Generally does not define company's fundamental objects
Powers	Defines outer limits of corporate powers	Regulates exercise of powers
Relationship	Superior to Articles	Subordinate to Memorandum
Alteration	More difficult and subject to statutory requirements	Generally comparatively easier
Ultra vires	Act beyond MOA may be ultra vires company	Articles cannot authorise something prohibited by MOA
Binding effect	Binds company and members subject to the Act	Also binds company and members
Relationship with outsiders	More significant	Primarily internal
Compulsory nature	Fundamental constitutional document	Required under the Act, subject to statutory framework

7. MOA Defines the Company's Limits

The most important distinction is:

MOA = What the company is authorised to do.

AOA = How the company will do it.

Example

Suppose the MOA permits a company to carry on:

Textile manufacturing.

The Articles may provide:

The Board of Directors can enter into contracts for purchasing machinery.

Therefore:

MOA → Object/power

AOA → Internal procedure for exercising that power

8. Doctrine of Ultra Vires

The MOA is closely connected with the **Doctrine of Ultra Vires**.

If an act is beyond the objects or powers contained in the MOA, it may be **ultra vires the company**.

Such an act cannot ordinarily be validated merely by altering the Articles.

Therefore:

MOA = Boundary of corporate powers

AOA = Internal rules within that boundary

This is also why your earlier **2019 Q5 / 2024 Q4 — Ultra Vires** question is closely connected with this topic.

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9. Doctrine of Constructive Notice

The MOA and AOA are public documents.

Persons dealing with the company are generally presumed to have notice of their contents.

This is called the:

Doctrine of Constructive Notice.

We already studied this as **2021 Question 3**.

10. Doctrine of Indoor Management

The harshness of constructive notice is limited by the **Doctrine of Indoor Management**.

Under the Turquand rule, an outsider dealing with a company may generally assume that internal procedures have been properly followed, unless circumstances require inquiry or an exception applies.

Therefore:

Constructive Notice → Outsider knows public documents

Indoor Management → Outsider need not ordinarily investigate internal formalities

11. Alteration of Memorandum

The MOA can be altered only according to the Companies Act.

For example:

- change of name;
- alteration of objects;
- alteration of capital;
- change of registered office in certain circumstances.

The procedure depends upon the particular clause being altered.

12. Alteration of Articles

Under **Section 14**, a company may alter its Articles by passing a **special resolution**, subject to the Companies Act and the company's constitutional framework.

The altered Articles must remain consistent with:

- the Companies Act;
- the Memorandum.

13. Relationship Between MOA and AOA

The hierarchy can be remembered as:

Companies Act

⬇ **Memorandum of Association**

⬇ **Articles of Association**

⬇ **Resolutions / Management Acts**

Therefore:

Articles cannot override the Memorandum, and neither can override the Companies Act.

14. Binding Effect — Section 10

The Memorandum and Articles, when registered, bind the company and its members to the extent provided by **Section 10**.

They operate as a statutory contract between:

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- company and members; and
- members among themselves,

subject to the statutory framework.

15. Important Case Law

⭐ **Ashbury Railway Carriage & Iron Co. Ltd. v. Riche**

A leading case on the **Doctrine of Ultra Vires**.

It established that an act outside the objects of the company's Memorandum is beyond the company's capacity.

⭐ **Royal British Bank v. Turquand**

A leading case on the **Doctrine of Indoor Management**, relevant to the relationship between the company's public documents and internal procedures.

⭐ **Eley v. Positive Government Security Life Assurance Co.**

The case illustrates principles concerning the legal effect of Articles and the circumstances in which Articles may create enforceable rights.

16. Easy Example

Suppose:

MOA says: Company may carry on software development business.

AOA says: Board may borrow money up to ₹10 crore with prescribed approval.

Now:**Borrowing ₹5 crore for software development**

→ potentially within corporate objects.

But:**Company starts an entirely unrelated business outside its objects**

→ may be ultra vires the company.

And:**Board follows the borrowing procedure internally**

→ governed by AOA.

17. Exam Diagram

Draw this diagram:

COMPANIES ACT

⬇️ **MEMORANDUM"WHAT the company can do"**

⬇️ **ARTICLES"HOW the company manages itself"**

⬇️ **MANAGEMENT / TRANSACTIONS**

This is an excellent quick diagram for a 15-mark answer.

18. Important Points to Memorise

MOASection 4 → Contents

Think:

N-O-L-C-S

N → Name

O → Objects

L → Liability

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C → Capital
S → Subscription
AOA
Section 5 → Regulations for management
Think:**"Internal Rule Book."**
19. Five-Line Exam Answer
If you have very little time, write:
The Memorandum of Association is the charter of the company and defines its constitution, objects and fundamental limits. The Articles of Association contain regulations for the internal management of the company. The Memorandum is superior to the Articles and the Articles cannot authorise anything contrary to the Memorandum or the Companies Act. The Memorandum is closely associated with the doctrine of ultra vires, while the Articles regulate the internal exercise of corporate powers. Both documents, when registered, have binding effect under Section 10 of the Companies Act, 2013.
20. Conclusion
The MOA and AOA together form the constitutional framework of a company. The **Memorandum establishes the company's identity, objects and external boundaries**, while the **Articles regulate its internal administration and management**.
⭐ **Best LL.M. conclusion:**
"The Memorandum may be regarded as the constitution or charter of the company, defining the sphere within which it may operate, whereas the Articles constitute the internal rule book by which that sphere is administered. The Articles must always remain subordinate to the Memorandum and the Companies Act."
🔥 **Quick Revision**
MOA = WHAT
AOA = HOW
Section 4 = MOA contents
Section 5 = AOA
Section 10 = Binding effect
Section 14 = Alteration of Articles
Ultra Vires → MOA
Indoor Management → AOA/internal procedure

QUESTION 6 — 2019
Explain the Procedure for Transfer of Shares and Rectification of the Register of Members
1. Introduction
Shares of a company are generally **movable property** and are transferable in accordance with the Articles of Association and the Companies Act, 2013.
The important provisions are:

- **Section 44** — Shares are movable property

- **Section 56** — Transfer and transmission of securities
- **Section 58** — Refusal of registration and appeal
- **Section 59** — Rectification of register of members

This question has **two parts**:

1. Transfer of shares
2. Rectification of register of members

PART I — TRANSFER OF SHARES

2. Meaning of Transfer of Shares

Transfer of shares means the **voluntary transfer of ownership/interest in shares from one person to another**.

Example

A holds 1,000 shares in ABC Ltd.

A sells/transfers 500 shares to B.

After valid registration of the transfer:

A → Transferor

B → Transferee

3. Section 44 — Shares as Movable Property

Section 44 provides that:

Shares or other interest of a member in a company are movable property.

They are transferable in the manner provided by:

- the Articles of Association; and
- the Companies Act.

Therefore, shares are generally transferable, but the transfer must comply with the applicable legal requirements.

4. Transferor and Transferee

Transferor

The existing shareholder who transfers the shares.

Transferee

The person to whom the shares are transferred.

Example

If A transfers shares to B:

A = Transferor

B = Transferee

5. Procedure for Transfer of Shares

Step 1 — Transfer Agreement

The transferor and transferee agree upon the transfer of shares.

The consideration, number of shares and other relevant terms are determined.

Step 2 — Transfer Instrument

The prescribed instrument of transfer must be properly completed and executed.

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For physical securities, the prescribed transfer instrument is generally **Form SH-4**, subject to the applicable rules and exemptions.
It should contain details such as:

- name of transferor;
- name of transferee;
- number and class of shares;
- distinctive numbers;
- consideration;
- signatures.

Step 3 — Stamp Duty
The transfer instrument must be duly stamped as required by applicable law.
Stamp duty requirements must be complied with before registration.
Step 4 — Execution
The transfer instrument must be signed by:

- transferor; and
- transferee,

as required.
The prescribed requirements regarding witnesses/attestation should also be followed where applicable.
Step 5 — Delivery to Company
The transfer instrument, together with the relevant share certificate or letter of allotment, must be delivered to the company within the statutory period.
Section 56
The company shall not register a transfer unless a proper instrument of transfer has been delivered within the prescribed period, subject to statutory exceptions.
6. Company Examines the Transfer
After receiving the documents, the company examines whether:

- the transfer instrument is properly completed;
- signatures are genuine;
- stamp duty requirements are satisfied;
- share certificate is produced;
- the Articles permit the transfer;
- there are any legal restrictions.

7. Registration of Transfer
If the requirements are satisfied, the company registers the transfer.
The transferee's name is entered in the **Register of Members**.
This is important because registration establishes the transferee as a member of the company for the purposes of the statutory register.
8. Issue of Share Certificate

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After registration, the company completes the necessary records and issues/endorses the share certificate in accordance with the statutory requirements.

9. Restrictions on Transfer

Public Company

The shares of a public company are generally freely transferable, subject to the Companies Act and applicable restrictions.

Private Company

A private company generally has restrictions on transfer of shares through its Articles.

Therefore:

Private company → restricted transfer

Public company → generally free transfer

10. Refusal of Registration — Section 58

A company may refuse to register a transfer where permitted by law.

In the case of a **private company**, refusal must be in accordance with its Articles and applicable statutory provisions.

In the case of a **public company**, securities are generally freely transferable and refusal is subject to the statutory requirements.

11. Notice of Refusal

Where the company refuses to register a transfer, it must communicate the refusal and reasons in the prescribed manner within the statutory period.

This ensures transparency and enables the affected person to challenge the refusal.

12. Appeal Against Refusal

Under **Section 58**, an aggrieved person may appeal to the **National Company Law Tribunal (NCLT)** against refusal to register transfer in accordance with the statutory provisions.

Thus:

Company refuses transfer

↓

Aggrieved person

↓

NCLT

PART II — RECTIFICATION OF REGISTER OF MEMBERS

13. Meaning of Register of Members

The **Register of Members** is the company's statutory record containing particulars of its members and their shareholding.

It is an important document because membership rights are connected with registration.

14. Meaning of Rectification

Rectification means correcting an incorrect, incomplete or unlawful entry in the Register of Members.

It may involve:

- inserting a name;

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- removing a name;
- correcting particulars;
- correcting the number of shares;
- correcting an erroneous transfer entry.

15. Section 59 — Rectification of Register

Section **59** provides the statutory mechanism for rectification of the Register of Members. Where:

- a person's name is wrongly entered;
- a person's name is wrongly omitted;
- there is an unreasonable delay in entering a person;
- there is an unreasonable delay in removing a name; or
- an incorrect entry exists,

the aggrieved person may seek rectification.

16. Who Can Apply?

Depending upon the circumstances, an application may be made by:

- the aggrieved person;
- a member;
- the company;
- other persons having the statutory right.

The application is made before the **NCLT** in accordance with Section 59.

17. Grounds for Rectification

1. Wrongful Entry

A person's name has been entered as a member when he is not legally entitled to be registered.

2. Wrongful Omission

A person who is legally entitled to be a member has been left out.

3. Unreasonable Delay

There is unreasonable delay in:

- entering a person's name; or
- removing a person's name.

4. Incorrect Particulars

The register contains incorrect particulars concerning membership or shares.

18. Powers of NCLT

The Tribunal may:

- order rectification;
- direct insertion of a name;
- direct removal of a name;
- correct particulars;
- direct the company to register a transfer;
- award costs;

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- make appropriate consequential orders.

19. Protection of Aggrieved Persons

The rectification mechanism protects persons whose legitimate membership rights have been wrongly affected.

Example

A validly purchases shares from A.

The company refuses to register B's name despite compliance with the statutory requirements.

B may seek appropriate relief under **Section 59**.

20. Difference Between Transfer and Transmission

This is a common examination point.

Transfer	**Transmission**
Voluntary act	Operation of law
Usually sale/gift	Death, insolvency, succession etc.
Transfer instrument normally required	No voluntary transfer instrument in the same sense
Transferor + transferee	Legal representative/successor
Section 56	Section 56 also deals with transmission

Easy memory:

Transfer = Act of parties

Transmission = Operation of law

21. Transfer vs Rectification

Transfer of Shares	**Rectification**
Changes ownership/membership through a valid transfer	Corrects an error or unlawful entry
Section 56	Section 59
Transferor → Transferee	Wrong entry → Correct entry
Usually voluntary	Usually corrective/remedial
Registration by company required	Tribunal may order correction

22. Important Case Law

⭐ **Mannalal Khetan v. Kedar Nath Khetan**

The Supreme Court emphasised that statutory requirements relating to transfer of shares must be complied with and cannot simply be bypassed.

⭐ **LIC v. Escorts Ltd.**

The Supreme Court discussed principles concerning transferability of shares and corporate control.

⭐ **Bajaj Auto Ltd. v. N.K. Firodia**

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The Supreme Court considered the issue of refusal to register transfer of shares and the limits on directors' discretion.

These cases can strengthen an LL.M. answer, particularly when discussing **refusal of transfer**.

23. Important Statutory Provisions

Section	Subject
44	Shares are movable property
46	Share certificate
56	Transfer and transmission
58	Refusal of registration and appeal
59	Rectification of Register of Members

Memory Trick:

44 → Movable

56 → Transfer

58 → Refusal

59 → Rectification

24. Examination Flow Chart — Transfer

Transferor↓Agreement with Transferee↓Transfer Instrument / SH-4↓Stamp Duty↓Execution↓Submit to Company↓Company examines documents↓Registration↓Transferee's name entered in Register of Members

25. Examination Flow Chart — Rectification

Wrong Entry / Omission

↓Application under Section 59↓NCLT↓Examination of claim↓Order for Rectification↓Company corrects Register

26. Example — Complete Question

Suppose A owns 1,000 shares in ABC Ltd. and transfers them to B.

A and B complete the prescribed transfer documentation and submit it to the company.

If ABC Ltd. validly registers the transfer:

A → Transferor

B → Transferee

B's name → Register of Members

But suppose the company wrongly refuses to register B despite the legal requirements being satisfied.

B may seek the appropriate remedy under **Sections 58 and 59**, depending on the precise nature of the dispute.

27. Importance of Transfer of Shares

Transferability of shares:

1. provides liquidity to investors;
2. facilitates investment;

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3. enables change of ownership;
4. assists corporate restructuring;
5. provides an exit mechanism for shareholders.

However, in a private company, reasonable restrictions contained in its Articles may apply.

28. Importance of Rectification

Rectification ensures that the Register of Members accurately reflects the legal position.

It protects:

- shareholders;
- transferees;
- investors;
- companies;
- creditors.

An incorrect register can affect:

- voting rights;
- dividend rights;
- participation in meetings;
- ownership disputes.

29. Conclusion

The transfer of shares is a legally regulated process through which ownership or interest in shares passes from one person to another. **Section 56** provides the principal statutory framework, while **Section 58** deals with refusal of registration and appeal.

Where the Register of Members contains an erroneous entry or omission, **Section 59** provides a remedy through rectification before the NCLT.

⭐ **Best LL.M. examination conclusion**

"Transferability is one of the essential incidents of shares, subject to the restrictions imposed by law and the Articles. At the same time, the Register of Members must accurately reflect the legal ownership of shares. Sections 56, 58 and 59 therefore provide a coordinated framework for transfer, refusal of registration and rectification."

🔥 **2-Minute Revision**

TRANSFER

44 → Shares = movable property

56 → Transfer/transmission

58 → Refusal + appeal

RECTIFICATION

59 → Rectification of Register

Remember:

"56 transfers, 58 challenges refusal, 59 corrects the register."

QUESTION 4 — DECEMBER 2017

Discuss Inter-Corporate Loans

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1. Introduction

An **inter-corporate loan** means a loan given by one company to another company or body corporate. Companies may also provide **guarantees or security** in connection with loans and may acquire securities of other bodies corporate.

The principal provision governing loans, guarantees, security and investments by companies is **Section 186 of the Companies Act, 2013**. The provision is intended to prevent excessive diversion of corporate funds and protect the interests of shareholders and creditors.

2. Meaning of Inter-Corporate Loan

An inter-corporate loan is broadly a loan or financial assistance provided by one company to another company/body corporate.

Example

ABC Ltd. → ₹50 lakh loan → XYZ Ltd.

ABC Ltd. is the lending company and XYZ Ltd. is the borrowing company.

Inter-corporate financial transactions may also involve:

- loans;
- guarantees;
- security for loans; and
- acquisition of securities of another body corporate.

3. Object of Section 186

The main objectives are:

1. To regulate corporate lending and investment.
2. To prevent misuse of company funds.
3. To protect shareholders and creditors.
4. To ensure proper Board/shareholder approval.
5. To maintain transparency in corporate financial transactions.
6. To prevent excessive concentration of investments through multiple layers of companies.

4. Maximum Limits — Section 186(2)

A company cannot directly or indirectly make loans, provide guarantees/security or acquire securities beyond the statutory limits.

The aggregate limit is:

60% of

Paid-up share capital + Free reserves + Securities premium account

OR

100% of

Free reserves + Securities premium account

whichever is higher.

Example

Suppose:

- Paid-up share capital = ₹10 crore

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- Free reserves = ₹5 crore
- Securities premium = ₹2 crore

60% of ₹17 crore = **₹10.2 crore**

100% of ₹7 crore = **₹7 crore**

Therefore, the applicable limit is **₹10.2 crore**, being the higher amount.

5. Special Resolution When Limit Is Exceeded — Section 186(3)

Where the aggregate loans, investments, guarantees or securities exceed the limits under Section 186(2), the company generally requires **prior authorisation by a special resolution** of the general meeting.

There are statutory exceptions, including specified transactions involving wholly owned subsidiaries and joint ventures.

6. Board Resolution — Section 186(5)

A loan, guarantee, security or investment covered by Section 186 must be sanctioned by a resolution at a **meeting of the Board**, with the consent of all directors present at that meeting.

Where a term loan from a public financial institution is subsisting, prior approval of that institution may also be required, subject to the statutory exception.

7. Rate of Interest — Section 186(7)

A company cannot give a loan under Section 186 at a rate of interest lower than the prevailing yield of the relevant Government Security closest to the tenor of the loan.

The relevant Government Security may be:

- 1 year;
- 3 years;
- 5 years; or
- 10 years,

depending upon the tenor of the loan.

Purpose

This prevents a company from improperly lending its funds at an artificially low rate.

8. Restriction During Deposit Default — Section 186(8)

A company which is in default in repayment of deposits accepted by it or payment of interest on such deposits cannot, while the default continues, give:

- any loan;
- guarantee;
- security; or
- make an acquisition covered by Section 186.

This is an important protection for depositors.

9. Disclosure Requirements — Section 186(4)

The company must disclose in its financial statements the full particulars of:

- loans given;
- investments made;

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- guarantees given;
- securities provided; and
- the purpose for which the loan, guarantee or security is proposed to be utilised.

This promotes **corporate transparency**.

10. Register of Loans and Investments — Section 186(9)

Every company giving loans, guarantees, securities or making acquisitions covered by Section 186 must maintain a **register** containing the prescribed particulars.

The register is maintained at the registered office and is available for inspection by members subject to the statutory conditions.

11. Two-Layer Restriction

Section 186(1) generally restricts a company from making investments through **more than two layers of investment companies**, subject to statutory exceptions.

This is intended to prevent complicated corporate structures being used to conceal or excessively multiply investments.

There are exceptions, including certain foreign-company acquisitions and subsidiaries having investment subsidiaries where required by law.

12. Exemptions

Section 186(11) provides exemptions from most of the requirements of Section 186 for specified categories and transactions.

For example, specified loans, guarantees, securities or investments made in the ordinary course of business by certain:

- banking companies;
- insurance companies;
- housing finance companies;
- companies engaged in financing industrial enterprises;
- companies providing infrastructure facilities,

may fall within the statutory exemptions.

Certain specified investment activities of investment companies and eligible NBFCs are also covered by the exemptions.

13. Inter-Corporate Loan vs Loan to Director

This distinction is important.

Inter-Corporate Loan

Primarily regulated by:

Section 186

Loan to Directors / Persons in whom Directors are interested

Primarily regulated by:

Section 185

Therefore, do not write only Section 185 when answering an **inter-corporate loan** question.

14. Consequences of Contravention

Contravention of Section 186 can attract statutory penalties against:

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- the company; and
- officers in default.

The current statutory penalty is prescribed in **Section 186(13)**.

15. Importance of Inter-Corporate Loans

Inter-corporate loans can be useful for:

1. financing subsidiaries;
2. supporting group companies;
3. meeting temporary financial requirements;
4. facilitating business expansion;
5. efficient utilisation of surplus funds.

However, unrestricted lending can expose shareholders and creditors to substantial risk. Therefore, Section 186 balances:

Corporate financial flexibility + protection of stakeholders

16. Example

Suppose **ABC Ltd.** has surplus funds and wants to give a ₹20 crore loan to **XYZ Ltd.**

ABC Ltd. must consider:

1. Section 186 limits;
2. Board approval;
3. special resolution, if required;
4. applicable interest-rate requirement;
5. disclosure in financial statements;
6. register requirements;
7. whether any statutory prohibition or exemption applies.

Only after complying with the applicable requirements should the transaction be undertaken.

17. Important Provisions to Memorise

Section	Provision
185	Loans to directors and connected persons
186(1)	Two-layer investment-company restriction
186(2)	Monetary limits
186(3)	Special resolution when limits exceeded
186(4)	Disclosure
186(5)	Board approval
186(7)	Minimum interest rate
186(8)	Restriction during deposit default
186(9)	Register
186(11)	Exemptions

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Section	Provision
186(13)	Penalty

18. Examination Flow Chart

Company proposes loan to another company↓

Section 186

↓Check statutory limit↓Board approval↓Special Resolution if required↓Check interest-rate requirement↓Give loan↓Disclosure in financial statements↓Maintain statutory register

19. Conclusion

Inter-corporate loans are an important means of corporate financing, but they involve the deployment of company funds and therefore require statutory regulation. **Section 186 of the Companies Act, 2013** regulates loans, guarantees, securities and investments by companies through monetary limits, Board and shareholder approvals, disclosure requirements, interest-rate restrictions and maintenance of records.

⭐ **Best LL.M. examination conclusion**

"Inter-corporate loans facilitate efficient utilisation of corporate funds and support group and business operations, but unrestricted lending may prejudice shareholders and creditors. Section 186 therefore seeks to maintain a balance between commercial flexibility and responsible corporate governance through limits, approvals, disclosures and statutory safeguards."

🔥 **1-Minute Revision**

Remember:

185 → Directors

186 → Inter-corporate loans/investments

186(2) → 60% / 100% limit

186(3) → Special Resolution

186(5) → Board approval

186(7) → Minimum interest

186(8) → No lending during deposit default

186(9) → Register

186(13) → Penalty

Memory line:

"Limit → Board → Special Resolution → Interest → Disclosure → Register."

QUESTION 5 — DECEMBER 2017

Discuss the Borrowing Powers of a Company

1. Introduction

A company requires funds for carrying on its business, purchasing assets, expansion and meeting working-capital requirements. One important source of finance is **borrowing**.

The power to borrow is generally exercised by the **Board of Directors**, subject to:

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- the Companies Act, 2013;
- the Memorandum of Association;
- Articles of Association;
- resolutions of shareholders where required; and
- other applicable laws.

Borrowing power means the legal authority of a company to raise money by creating a debt or liability.

2. Sources of Borrowing

A company may raise borrowed funds through:

1. Bank loans
2. Financial institutions
3. Debentures
4. Bonds
5. Loans from other companies
6. Public deposits, where permitted
7. Commercial borrowings
8. Other lawful forms of debt financing

3. Borrowing Powers of the Board — Section 179

Under **Section 179(3)**, the Board of Directors must exercise specified powers by means of resolutions passed at a meeting of the Board.

The power to **borrow monies** is one of these important Board powers.

Therefore:

Borrowing is primarily a Board power, subject to statutory and constitutional restrictions.

The Board must act within the company's:

- objects;
- Articles;
- statutory limits.

4. Shareholder Approval — Section 180

Section **180(1)(c)** is extremely important.

The Board cannot borrow money where the money to be borrowed, together with the money already borrowed by the company, exceeds the aggregate of:

Paid-up share capital + free reserves + securities premium

unless the company has obtained the consent of its members by a **special resolution**.

Certain temporary loans obtained from the company's bankers in the ordinary course of business are excluded from the calculation in accordance with the statutory provision.

5. Example

Suppose:

- Paid-up share capital = ₹10 crore
- Free reserves = ₹5 crore
- Securities premium = ₹2 crore

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Aggregate:

₹17 crore

If existing borrowings are ₹15 crore and the company proposes another ₹5 crore:

Total borrowings = ₹20 crore

This exceeds ₹17 crore.

Therefore, subject to the statutory exceptions:

Special resolution of members is required.

6. Borrowing Beyond the Statutory Limit

If the Board wants to borrow beyond the limit prescribed under Section 180(1)(c), it must obtain the required **special resolution**.

This ensures that major borrowing decisions are not taken by directors without shareholder oversight.

7. Borrowing Must Be Within the Company's Objects

The company's borrowing must also be consistent with its **Memorandum of Association**.

If borrowing is connected with an object authorised by the Memorandum, it is generally within corporate capacity.

But borrowing for an object completely outside the company's objects may raise issues under the **Doctrine of Ultra Vires**.

Remember:

MOA → Capacity

AOA → Internal procedure

Board → Exercise of borrowing power

Members → Approval where Section 180 requires it

8. Articles of Association

The Articles may regulate:

- who may borrow;
- how borrowing decisions are made;
- limits on directors' authority;
- creation of security;
- execution of loan documents;
- appointment of authorised signatories.

The Articles cannot, however, override the Companies Act.

9. Methods of Borrowing

A company can borrow through various instruments.

A. Secured Loans

Loans secured by:

- mortgage;
- charge;
- hypothecation;
- pledge.

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B. Unsecured Loans

Loans without specific security over company assets.

C. Debentures

Long-term debt instruments issued by the company.

D. Bonds

Debt instruments through which the company raises funds from investors.

10. Borrowing and Creation of Charges

Where borrowing is secured against company assets, the company may create a **charge** over those assets.

For example:

Company → Bank Loan↓Land/building given as security↓Charge created

The company must comply with the statutory requirements relating to registration of charges.

11. Registration of Charges — Section 77

Under **Section 77**, it is the duty of the company to register charges created on its property, assets or undertaking, whether tangible or otherwise, and to comply with the prescribed requirements.

Registration provides public notice of the charge.

12. Borrowing Powers and Directors' Duties

Directors must exercise borrowing powers:

- in good faith;
- for proper corporate purposes;
- with due care;
- within their statutory authority;
- in the interests of the company.

They should not use corporate borrowing power for personal purposes.

13. Ultra Vires Borrowing

An **ultra vires borrowing** occurs when the borrowing is beyond the legal capacity of the company.

For example:

The MOA authorises the company to conduct a particular business, but the company borrows money for a completely unrelated and unauthorised purpose.

The validity and enforceability of such borrowing depend on the precise nature of the transaction and the applicable legal principles.

14. Borrowing Beyond Directors' Authority

A distinction must be made between:

A. Borrowing ultra vires the company

The company itself lacks capacity.

B. Borrowing within company capacity but beyond directors' authority

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The company may have borrowing capacity, but the directors may have exceeded the authority delegated to them.

This distinction is very important in company law.

15. Doctrine of Indoor Management

An outsider dealing with a company may generally assume that internal procedures have been properly followed.

Therefore, where:

- the company has capacity to borrow;
- the transaction appears regular; and
- the lender acts in good faith,

the **Doctrine of Indoor Management** may protect the outsider against certain internal irregularities.

This connects directly with **2017 Q8**, which we will study next.

16. Consequences of Improper Borrowing

Improper borrowing may result in:

- inability to enforce the transaction against the company in some circumstances;
- personal liability of directors;
- shareholder action;
- regulatory consequences;
- disputes concerning security;
- other statutory consequences.

The precise consequence depends on whether the defect concerns:

- corporate capacity;
- Board authority;
- shareholder approval;
- internal procedure.

17. Borrowing and Debentures

A company may raise substantial long-term funds through **debentures**.

Debentures may be:

- secured or unsecured;
- convertible or non-convertible;
- redeemable;
- registered in accordance with applicable law.

The issue of debentures is therefore an important method of exercising the company's borrowing power.

18. Borrowing from Directors

Companies may obtain loans from directors subject to the Companies Act and applicable rules.

However, transactions involving directors must be carefully distinguished from **loans to directors**, which are governed by **Section 185**.

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Therefore:

Loan from a director ≠ Loan to a director.

19. Borrowing and Deposits

A company may accept deposits only in accordance with the provisions of the Companies Act and the applicable rules.

The company must comply with requirements relating to:

- eligibility;
- limits;
- disclosures;
- repayment;
- security, where applicable;
- interest;
- filing and reporting.

Therefore, accepting public/company deposits is not an unrestricted borrowing power.

20. Important Sections

Section	Provision
179(3)(d)	Board's power to borrow money
180(1)(c)	Restrictions on borrowing beyond prescribed limit
180(1)(a)	Disposal of undertaking/property in specified circumstances
77	Registration of charges
71	Debentures
185	Loans to directors
186	Loans, guarantees, securities and investments
73 onwards	Deposits

21. Important Case Law

⭐ **Attorney General v. Great Eastern Railway Co.**

The case is associated with the doctrine of **ultra vires** and the limits of corporate powers.

⭐ **Royal British Bank v. Turquand**

The case established the **Doctrine of Indoor Management**, which is relevant where outsiders rely on the apparent authority of company officers despite internal procedural irregularities.

⭐ **Rolled Steel Products (Holdings) Ltd. v. British Steel Corporation**

Useful for understanding transactions involving corporate powers and the consequences of acts beyond or improperly exercising corporate authority.

22. Borrowing Powers — Easy Flow Chart

COMPANY NEEDS FUNDS

↓

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BOARD OF DIRECTORS

Section 179

↓

Check:

MOA + AOA + Companies Act

↓

Existing + proposed borrowing

↓

Within Section 180 limit?

↙ ↘

YES **NO**

↓ ↓

Board action **Special Resolution**

↓

Borrowing

↓

If secured:

Creation + Registration of Charge

23. Key Difference — Section 179 and Section 180

This is very important for the examination.

Section 179

Who exercises borrowing power?

Board of Directors

Section 180

When is shareholder approval required?

When borrowing crosses the statutory threshold specified in Section 180(1)(c), subject to exceptions.

Memory:

179 = Board

180 = Members' control over major borrowing

24. Conclusion

Borrowing is an essential corporate power because companies frequently require external finance for their business operations and expansion. The **Board of Directors** exercises the borrowing power under Section 179, but significant borrowings are subject to the restrictions and shareholder approval requirements of **Section 180**.

The borrowing must also remain within the company's constitutional and statutory framework. Where secured borrowing is undertaken, the company must comply with the law relating to **charges**, and directors must exercise their powers for proper corporate purposes.

⭐ **Best LL.M. examination conclusion**

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"The borrowing power of a company is an important incident of corporate capacity, but it is not an unlimited power. The Companies Act, 2013 balances the company's need for finance with shareholder and creditor protection by regulating Board authority, imposing limits on substantial borrowings, requiring shareholder approval in appropriate cases and ensuring transparency through registration of charges."

🔥 **1-Minute Revision**

179(3)(d) → Board can borrow

180(1)(c) → Major borrowing restriction

Special Resolution → When statutory borrowing limit is exceeded

77 → Registration of charge

71 → Debentures

185 → Loans to directors

186 → Inter-corporate loans/investments

Memory line:

"Board borrows under 179; members control major borrowing under 180; security is registered under 77."

QUESTION 7 — DECEMBER 2017

Explain Debentures and Charges

This is an important **Company Law financing question** because it covers two related but distinct concepts: **debentures** as a means of raising debt and **charges** as security over company assets.

PART I — DEBENTURES

1. Meaning of Debenture

A **debenture** is a debt instrument issued by a company acknowledging or creating a debt. Under **Section 2(30) of the Companies Act, 2013**, "debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the company's assets or not.

Thus:

A debenture represents borrowed money of the company and creates a debt owed by the company to the debenture-holder.

2. Characteristics of Debentures

1. It represents debt

A debenture-holder is a **creditor**, not an owner like an equity shareholder.

2. Fixed return

Interest is generally payable according to the terms of issue, irrespective of whether the company makes a profit, subject to applicable law and the terms of the instrument.

3. Repayment

Debentures are generally repayable according to their terms.

4. May be secured or unsecured

A debenture may be secured by a charge over company assets or may be unsecured.

5. No voting rights

Under **Section 71(2)**, a company cannot issue debentures carrying voting rights.

6. Debenture-holder is a creditor

The debenture-holder does not ordinarily participate in the management of the company merely by holding debentures.

3. Types of Debentures

A. Secured Debentures

These are backed by a charge over specified company assets.

If the company defaults, the security may be enforced according to law.

B. Unsecured Debentures

These are not backed by a specific security over the company's assets.

The holder is essentially an unsecured creditor, subject to the terms and applicable insolvency law.

C. Convertible Debentures

These carry an option/right to convert wholly or partly into shares according to the terms of issue.

Under **Section 71(1)**, issue of debentures with an option to convert into shares, wholly or partly, requires approval by a **special resolution**.

D. Non-Convertible Debentures

These do not carry a conversion option and remain debt instruments until redemption.

E. Redeemable Debentures

These are issued with a specified maturity/redemption arrangement.

F. Perpetual Debentures

Historically, perpetual debentures were described as debentures without a fixed date for repayment, subject to the applicable statutory framework and terms of issue.

For an examination answer, it is safer to emphasise the statutory categories and terms applicable under the current Companies Act and Rules.

4. Rights of Debenture-Holders

Debenture-holders generally have rights such as:

1. Right to receive interest

They are entitled to interest according to the terms of issue.

2. Right to repayment

They are entitled to repayment of principal according to the terms of issue.

3. Right to enforce security

Secured debenture-holders have rights in relation to the security created for their benefit.

4. Right to approach the Tribunal

Where statutory conditions are satisfied, debenture-holders/debenture trustees can seek appropriate relief before the Tribunal.

5. Right to receive information

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They are entitled to information and documents according to the terms of issue and applicable law.

5. Debenture Trustee

Where the statutory requirements apply, the company must appoint **debenture trustees** for the protection of debenture-holders.

Under Section 71, the debenture trustee is required to take steps to protect the interests of debenture-holders and redress their grievances according to the Act and Rules.

Role of Debenture Trustee

The trustee may:

- protect debenture-holders' interests;
- monitor security;
- take steps upon default;
- represent debenture-holders;
- take appropriate legal action where necessary.

6. Company's Duty to Pay Interest and Redeem

Under **Section 71(8)**:

A company must pay interest and redeem debentures according to the terms and conditions of their issue.

Therefore, failure to pay interest or redeem debentures can have serious legal consequences.

PART II — CHARGES

7. Meaning of Charge

Under **Section 2(16)**, a **charge** means an interest or lien created on the property or assets of a company or any of its undertakings, or both, as security, and includes a mortgage.

In simple words:

A charge is a security interest created over company property or assets to secure repayment of a debt or performance of an obligation.

8. Example of Charge

Suppose:

ABC Ltd. borrows ₹10 crore from Bank

↓

ABC Ltd. gives its factory building as security

↓

A **charge** is created over the factory.

If the company defaults, the bank may enforce its security according to law.

9. Types of Charges

The two principal types are:

A. Fixed Charge

A fixed charge is created over a specific and identifiable asset.

Examples:

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- land;
- building;
- specific machinery.

The company generally cannot freely dispose of the charged asset without dealing with the charge according to its terms.

B. Floating Charge

A floating charge generally covers a class of changing assets, such as:

- stock;
- book debts;
- circulating assets.

The company may ordinarily deal with such assets in the ordinary course of business until the charge crystallises according to law.

10. Fixed Charge vs Floating Charge

Fixed Charge	**Floating Charge**
Specific asset	Class of changing assets
Asset identified	Assets may change
Greater control over asset	Company can generally deal with assets in ordinary course
Does not ordinarily float over changing assets	Floats over a changing class of assets
Example: building	Example: stock

11. Registration of Charges — Section 77

This is one of the most important statutory provisions.

Under **Section 77**, it is the duty of every company creating a charge on its property, assets or undertaking to register the prescribed particulars of the charge with the **Registrar of Companies**. The normal statutory period is **30 days from creation**.

The particulars and relevant instrument must be filed in the prescribed manner.

12. Why Registration Is Important

Registration provides **public notice** of the charge.

A person dealing with the company's property can discover that the property is subject to a security interest.

This protects:

- creditors;
- lenders;
- purchasers;
- shareholders;
- the public.

13. Consequence of Non-Registration

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Under **Section 77(3)**, an unregistered charge is not taken into account by the liquidator or other creditors against the company.

Therefore:

Registration is extremely important for protection of the charge-holder's priority against the company and other creditors.

However, the underlying debt itself does not simply disappear merely because the charge was not registered.

14. Registration by Charge-Holder — Section 78

If the company fails to register the charge within the prescribed period, the **person in whose favour the charge is created** may apply to the Registrar for registration in accordance with Section 78.

The Registrar may permit registration after following the statutory procedure.

15. Modification of Charge — Section 79

Where there is a modification in:

- terms;
- conditions;
- extent; or
- operation

of a registered charge, the statutory provisions relating to registration apply as prescribed.

16. Satisfaction of Charge — Section 82

When a registered charge has been fully satisfied, the company must intimate the Registrar in the prescribed manner.

Under **Section 82**, the company is required to give intimation of payment or satisfaction in full within the statutory period.

Thus:

Creation → Registration

Modification → Registration

Satisfaction → Intimation

17. Register of Charges

Section 81

The Registrar maintains a **Register of Charges** containing particulars of charges registered under the Act.

The register is available for inspection subject to the statutory requirements.

Section 85

The company is also required to maintain its own register of charges as prescribed.

18. Date of Notice — Section 80

Once a charge is registered, a person acquiring the relevant property or interest is deemed to have notice of the charge from the date of registration.

This is important because registration gives the charge **public visibility**.

19. Debenture vs Charge

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This distinction is **very important**.

Debenture	Charge
Debt instrument	Security interest
Evidences debt owed by company	Secures debt/obligation
Holder is creditor	Charge-holder has security interest
May be secured or unsecured	Created over property/assets
Governed principally by Section 71 and related provisions	Governed principally by Sections 77–87
It can exist without a charge	A charge is normally created to secure an obligation

Easy memory:

Debenture = Debt

Charge = Security

20. Secured Debenture — Relationship

A secured debenture can involve **both**:

Debenture → Debt

-

Charge → Security

Example

ABC Ltd. issues ₹10 crore secured debentures.

The company creates a charge over its factory.

Therefore:

- Debenture = company's debt to debenture-holders
- Charge = security over factory

21. Important Statutory Sections

Debentures

Section	Subject
2(30)	Definition of debenture
71	Debentures
72	Nomination

Charges

Section	Subject
2(16)	Definition of charge
77	Duty to register charges
78	Application by charge-holder
79	Modification/acquisition of property subject to charge

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Section	Subject
80	Date of notice
81	Registrar's register of charges
82	Satisfaction of charge
85	Company's register of charges
86	Punishment for contravention

22. Examination Flow Chart

DEBENTURE

Company requires long-term finance

↓

Issue Debentures

↓

Debenture-holder becomes creditor

↓

Interest

↓

Redemption

If secured:

↓

Charge over company assets

CHARGE

Company borrows money

↓

Security created over asset

↓

Register with ROC

↓

Charge registered

↓

Debt repaid

↓

Satisfaction reported

23. Practical Example

ABC Ltd. wants to raise **₹50 crore**.

It issues secured debentures to investors.

The debenture holders are entitled to interest and repayment according to the terms.

ABC Ltd. creates a charge over its factory as security.

Therefore:

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₹50 crore instrument = Debenture
Security over factory = Charge
The charge must be registered according to the Companies Act.
24. Conclusion
Debentures are an important method by which companies raise borrowed capital. A debenture represents a **debt obligation**, while a charge provides **security for repayment**. The Companies Act, 2013 regulates the issue and redemption of debentures under **Section 71** and requires registration of charges under **Sections 77 onwards**. These provisions protect debenture-holders, lenders, creditors and other stakeholders.
⭐ **Best LL.M. examination conclusion**
"Debentures constitute an important source of borrowed capital, while charges provide security for corporate borrowings. The Companies Act, 2013 regulates both through provisions designed to ensure transparency, protection of creditors and proper disclosure of encumbrances over corporate assets."
🔥 **2-Minute Revision**
DEBENTURES
Section 2(30) → Definition
Section 71 → Debentures
No voting rights → Section 71(2)
Convertible debentures → Special resolution
Debenture trustee → Protection of holders
Interest + redemption → According to terms
CHARGES
Section 2(16) → Definition
Section 77 → Registration
Section 78 → Charge-holder can apply
Section 80 → Notice
Section 81 → Registrar's register
Section 82 → Satisfaction
Section 85 → Company's register
⭐ **Golden line:**
"Debenture creates/evidences the debt; charge secures the debt."

QUESTION 8 — DECEMBER 2017
Discuss the Doctrine of Indoor Management
1. Introduction
The **Doctrine of Indoor Management** is an important principle of Company Law that protects outsiders dealing with a company.
The doctrine is an exception to the **Doctrine of Constructive Notice**.

While constructive notice assumes that outsiders know the contents of the company's public documents, the doctrine of indoor management allows an outsider to assume that the company's **internal procedures and formalities have been properly complied with**.

Constructive Notice = Outsider must know public documents.

Indoor Management = Outsider may assume internal procedures were properly followed.

2. Origin of the Doctrine

The doctrine was established in the famous English case:

⭐ **Royal British Bank v. Turquand (1856)**

This is also called the **Turquand Rule**.

3. Facts of Royal British Bank v. Turquand

The Articles of the company provided that the directors could borrow money if authorised by a resolution of the shareholders.

The directors borrowed money from **Turquand**.

However, the required shareholders' resolution had not actually been passed.

The company later argued that the borrowing was not binding because the internal requirement had not been complied with.

The Court rejected this argument.

It held that an outsider dealing with the company was entitled to assume that the necessary internal formalities had been properly complied with.

4. Principle Established

The principle is:

An outsider dealing with a company in good faith is entitled to presume that internal procedures required by the company's Articles have been duly complied with.

Therefore, an outsider normally does not have to investigate the company's internal proceedings.

5. Why the Doctrine Is Necessary

The doctrine is necessary because outsiders cannot reasonably be expected to investigate every internal matter of a company.

For example, an outsider cannot normally be expected to check:

- whether a Board meeting was properly held;
- whether the required quorum was present;
- whether a resolution was properly passed;
- whether internal approval was obtained;
- whether an officer was properly appointed.

Therefore, the doctrine facilitates commercial transactions.

6. Example

Suppose the Articles of ABC Ltd. provide:

Directors may borrow up to ₹10 crore after obtaining approval of the shareholders.

The directors borrow ₹5 crore from Bank X.

Bank X has no reason to suspect any irregularity.

Later, it is discovered that the shareholders' approval was not actually obtained.
Under the doctrine of indoor management, **Bank X may generally rely on the assumption that the internal requirement was properly complied with**, provided Bank X acted in good faith and no exception applies.

7. Relation with Doctrine of Constructive Notice

The two doctrines should always be discussed together.

Constructive Notice

A company has public documents such as:

- Memorandum;
- Articles.

An outsider dealing with the company is presumed to know their contents.

Indoor Management

The outsider is **not generally required to investigate internal compliance** with those documents.

Therefore:

Constructive Notice protects the company.

Indoor Management protects outsiders.

8. Difference Between the Two Doctrines

Constructive Notice	**Indoor Management**
Outsider is presumed to know public documents	Outsider may assume internal procedures were followed
Applies to external/public documents	Applies to internal management
Can operate harshly against outsiders	Provides protection to outsiders
Based on public availability	Based on presumption of regularity
Company can rely upon it	Outsider can rely upon it
Example: MOA/AOA	Example: internal Board/shareholder approval

9. Exceptions to the Doctrine

The Doctrine of Indoor Management is **not absolute**.
There are important exceptions.

Exception 1 — Knowledge of Irregularity

If the outsider **actually knows** that an internal procedure has not been followed, he cannot claim protection under the doctrine.

Example

A knows that the Board has not passed the required resolution but deliberately proceeds with the transaction.
A cannot rely on indoor management.

10. Exception 2 — Suspicion of Irregularity

If the circumstances are such that the outsider **ought to have made further inquiry**, he may not be protected.

For example:

If a transaction appears highly unusual or suspicious, the outsider cannot simply close his eyes to obvious irregularities.

Principle:

Suspicion + failure to inquire → protection may be lost.

11. Exception 3 — Forgery

The doctrine does not protect transactions based on **forged documents or signatures**.

A forged document cannot create valid authority merely because the outsider claims to have relied upon the company's apparent internal regularity.

Important case:

Ruben v. Great Fingall Consolidated

The doctrine was held not to protect a transaction involving forgery.

12. Exception 4 — No Knowledge of Articles

The doctrine cannot be used to contradict the actual contents of the company's public constitutional documents.

An outsider cannot say:

"I assumed the Articles permitted this."

when the Articles clearly state otherwise.

The doctrine protects assumptions about **internal compliance**, not ignorance of the company's constitutional limits.

13. Exception 5 — Negligence

An outsider who is negligent and fails to make reasonable inquiry in circumstances requiring inquiry may lose the protection of the doctrine.

The protection is intended for persons who act:

- honestly;
- reasonably;
- in good faith.

14. Exception 6 — Acts Outside Apparent Authority

Where the person acting for the company has **no apparent authority** to enter into the transaction, the outsider may not be protected.

Example

A junior clerk of a company enters into a major borrowing transaction which is clearly outside the clerk's normal authority.

The outsider cannot automatically assume that the clerk had authority.

15. Exception 7 — Knowledge of Lack of Authority

If the outsider knows that the officer lacks authority, the doctrine cannot be invoked.

Example

If the bank knows that the managing director has been expressly prohibited from borrowing on behalf of the company, it cannot subsequently rely on indoor management.

16. Important Cases

⭐ **1. Royal British Bank v. Turquand**

Principle:

Outsiders may assume that internal company procedures have been properly complied with. This is the **leading case**.

⭐ **2. Mahony v. East Holyford Mining Co.**

The case applied the principle that an outsider dealing with a company can generally assume that internal formalities have been complied with.

⭐ **3. Ruben v. Great Fingall Consolidated**

Exception: Forgery

The doctrine does not validate forged documents.

⭐ **4. Anand Bihari Lal v. Dinshaw & Co.**

The protection cannot be extended where the person dealing with the company fails to make necessary inquiry concerning the authority of the person acting on behalf of the company.

17. Indoor Management and Outsider's Good Faith

Good faith is very important.

The doctrine protects a person who:

- genuinely deals with the company;
- has no knowledge of the irregularity;
- is not negligent;
- has no reason to suspect wrongdoing.

Therefore:

Good faith + regular-looking transaction = strong protection

18. Importance of the Doctrine

The doctrine is important because it:

1. Facilitates commercial transactions

Business would become impossible if every outsider had to investigate every internal corporate procedure.

2. Protects innocent outsiders

It protects people who honestly rely on the apparent authority of company officers.

3. Promotes business certainty

It allows transactions to be completed without unnecessary investigation.

4. Balances constructive notice

It prevents the doctrine of constructive notice from becoming excessively harsh.

5. Encourages corporate efficiency

Companies can transact with outsiders without requiring outsiders to examine every internal resolution.

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19. Example for Examination

Suppose ABC Ltd.'s Articles provide:

The Managing Director may enter into contracts up to ₹5 crore with Board approval.

The Managing Director enters into a ₹3 crore contract with X.

X has no knowledge that the Board never actually passed the required approval.

If the transaction is otherwise within the company's powers and X acted honestly, X may rely on the **Doctrine of Indoor Management**.

But if X knew that the Board had refused approval, X cannot claim protection.

20. Limitations of the Doctrine

The doctrine does not mean:

"Outsiders can ignore everything."

An outsider must still consider:

- the company's public constitutional documents;
- the apparent authority of the officer;
- obvious irregularities;
- suspicious circumstances.

Therefore, the doctrine protects **reasonable reliance**, not reckless reliance.

21. Indoor Management and Ultra Vires

These doctrines must be distinguished.

Ultra Vires

An act beyond the company's constitutional powers.

Indoor Management

An internal procedural irregularity in exercising an otherwise valid corporate power.

Example:

MOA permits borrowing → company has power to borrow.

But:

Required internal approval was not obtained.

→ Indoor Management may protect an innocent outsider.

However:

MOA does not permit the company to undertake the transaction at all.

→ Indoor Management cannot normally cure that lack of corporate capacity.

22. Simple Diagram

Draw this in the examination:

COMPANY'S PUBLIC DOCUMENTS

MOA + AOA

↓

OUTSIDER

Constructive Notice

↓

But outsider need not normally investigate:

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INTERNAL PROCEDURES

Resolutions + Quorum + Approval

↓

INDOOR MANAGEMENT

↓

Protection of bona fide outsider

23. Constructive Notice + Indoor Management — Best Way to Remember

Constructive Notice

"I know what the documents say."

Indoor Management

"I can assume you followed your internal procedures."

Example:AOA says: Board approval required.

Outsider knows this.But outsider can normally assume:

"The Board must have obtained the required approval."

That is the **Turquand Rule**.

24. Important Points for LL.M. Answer

Remember these four words:

T — Turquand Leading case.

G — Good faith Outsider should act honestly.

I — Internal regularity

Outsider may presume internal compliance.

E — Exceptions

Knowledge, suspicion, forgery, negligence, lack of authority.

25. Conclusion

The Doctrine of Indoor Management is a fundamental principle of company law developed to protect outsiders dealing with companies. It complements the Doctrine of Constructive Notice by allowing a bona fide outsider to presume that internal corporate procedures have been properly followed.

However, the doctrine is subject to important exceptions, particularly where the outsider has knowledge of the irregularity, is put on inquiry by suspicious circumstances, or the transaction involves forgery or lack of apparent authority.

⭐ **Best LL.M. examination conclusion:**

"The Doctrine of Indoor Management represents a practical balance between corporate transparency and commercial convenience. While outsiders are presumed to know the contents of the company's public documents, they are not ordinarily required to investigate internal proceedings. The Turquand Rule therefore protects bona fide outsiders while its exceptions prevent the doctrine from becoming an instrument for negligence or fraud."

🔥 **2-Minute Revision**

Indoor Management = Turquand Rule

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Leading case:

➡ *Royal British Bank v. Turquand*

Rule:Outsider can presume internal formalities were complied with.

Exceptions:

1. **Knowledge of irregularity**
2. **Suspicion / duty to inquire**
3. **Forgery**
4. **Negligence**
5. **No authority**
6. **Knowledge of lack of authority**

Golden distinction:

Constructive Notice → Know the documents

Indoor Management → Assume internal compliance

Most important case:

Royal British Bank v. Turquand (1856)

Most important exception case:

Ruben v. Great Fingall Consolidated

QUESTION 6 — NOVEMBER/DECEMBER 2018

Examine Whether a Company Can Buy Back Its Own Securities

1. Introduction

Buy-back of securities means the purchase by a company of its own shares or other specified securities from its existing shareholders/security holders.

The Companies Act, 2013 permits a company to buy back its own securities, but only subject to strict statutory conditions.

The principal provisions are **Sections 68, 69 and 70** of the Companies Act, 2013.

Section 68 — Power of company to purchase its own securities

2. Meaning of Buy-Back

Buy-back means:

A company purchases its own shares or specified securities from its shareholders/security holders and consequently reduces the securities outstanding in the market.

Example

ABC Ltd. has 10 lakh equity shares.

It buys back 1 lakh of its own shares.

The company then cancels/extinguishes the securities bought back in accordance with law.

3. Why Do Companies Buy Back Their Securities?

A company may undertake buy-back for several reasons:

1. To return surplus cash to shareholders.
2. To improve earnings per share.
3. To consolidate the ownership structure.

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4. To reduce excess share capital.
5. To provide an exit opportunity to shareholders.
6. To improve financial ratios.
7. To increase shareholders' value.
8. To support efficient capital restructuring.

4. Sources of Buy-Back — Section 68

A company may purchase its own shares or other specified securities out of:

1. Free Reserves

2. Securities Premium Account

3. Proceeds of an earlier issue

However, the proceeds of an earlier issue of the **same kind of shares or same kind of specified securities** cannot ordinarily be used for buy-back.

Example

Equity shares cannot ordinarily be bought back merely by using proceeds from a fresh issue of equity shares.

5. Authorisation in Articles

The company's **Articles of Association** must authorise the buy-back.

If the Articles do not contain the necessary authority, they must first be altered in accordance with the Companies Act.

6. Approval by Shareholders

General Rule

A buy-back generally requires approval by a **special resolution** of the shareholders.

However, where the buy-back is **10% or less of the total paid-up equity capital and free reserves**, the Board may authorise it by a resolution passed at a Board meeting, subject to the statutory conditions.

This distinction is important.

7. Maximum Limit of Buy-Back

Under Section 68, the buy-back is subject to statutory limits.

A company may buy back its shares or specified securities up to **25% of the aggregate of paid-up capital and free reserves**, subject to the applicable statutory calculation and conditions.

For an equity share buy-back, the 25% limit is also subject to the specific requirement concerning the total paid-up equity capital in the relevant financial year.

8. Example

Suppose:**Paid-up capital + free reserves = ₹100 crore**

The statutory maximum based on the 25% limit would be:**₹25 crore**

However, the company must also satisfy the other applicable requirements and limits.

9. Debt-Equity Ratio

After the buy-back, the ratio of the company's:

Debt owed by the company to its paid-up capital and free reserves

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must ordinarily not exceed **2:1**, subject to the statutory framework and prescribed exceptions.

The purpose is to ensure that the company does not become excessively leveraged after returning capital to shareholders.

10. Fully Paid-Up Securities

Only **fully paid-up shares or specified securities** can be bought back.

Therefore:

Partly paid shares cannot ordinarily be bought back under Section 68.

This is an important examination point.

11. Methods of Buy-Back

A company may buy back its securities:

A. From Existing Shareholders/Security Holders

On a proportionate basis.

B. From Open Market

Subject to the applicable regulations and statutory conditions.

C. From Employees

Securities issued to employees pursuant to:

- stock option schemes; or
- sweat equity,

may be bought back subject to the law.

12. Declaration of Solvency

Before undertaking the buy-back, the company is required to make a **declaration of solvency** in the prescribed form.

The declaration states that the Board has made a full inquiry into the company's affairs and has formed the opinion that:

the company is capable of meeting its liabilities and will not become insolvent within the specified period after the buy-back.

The declaration is made in the prescribed manner.

13. Extinguishment of Securities

The company must **extinguish and physically destroy** the securities bought back within the statutory period.

The purpose is to ensure that securities purchased by the company are not improperly put back into circulation.

14. No Further Issue of Same Kind

After completing a buy-back, a company is generally restricted from making a further issue of the same kind of shares/securities for the prescribed period, subject to statutory exceptions.

The exceptions include certain situations such as:

- bonus issue;
- conversion of securities;

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- discharge of subsisting obligations.

15. Register of Buy-Back

The company must maintain a **register of securities bought back** containing the prescribed particulars.

The register provides an official record of the buy-back transactions.

16. Return of Buy-Back

After completion of the buy-back, the company must file the prescribed **return of buy-back** with the Registrar and, where applicable, the prescribed authority.

This ensures regulatory transparency.

17. Transfer to Capital Redemption Reserve — Section 69

Where securities are bought back out of:

- free reserves; or
- securities premium account,

an amount equal to the **nominal value of the shares bought back** must be transferred to the **Capital Redemption Reserve Account**.

Example

If shares having nominal value of ₹5 crore are bought back from free reserves:

₹5 crore → Capital Redemption Reserve

The purpose is to preserve the company's capital base.

18. Restrictions on Buy-Back — Section 70

A company cannot buy back its own securities in certain circumstances.

For example, buy-back is prohibited where the company is in default in respect of specified obligations relating to:

- repayment of deposits;
- interest on deposits;
- redemption of debentures;
- redemption of preference shares;
- payment of dividend;
- repayment of specified term loans or interest thereon.

The prohibition continues subject to the statutory requirements and exceptions.

19. No Buy-Back Through Subsidiary

A company cannot buy back its securities:

through any subsidiary company, whether directly or indirectly.

This prevents circumvention of the buy-back restrictions.

20. No Buy-Back Through Investment Company or Group

The Act also restricts buy-back through an investment company or group of investment companies, subject to the statutory framework.

The objective is to prevent indirect manipulation of the buy-back provisions.

21. Compliance with Law

The company must comply with:

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- Companies Act, 2013;
- applicable rules;
- securities regulations, where applicable;
- SEBI requirements for listed companies.

Therefore, a listed company must also consider the applicable **SEBI buy-back regulations**.

22. Buy-Back vs Reduction of Share Capital

These concepts should not be confused.

Buy-Back	**Reduction of Capital**
Governed principally by Section 68	Governed principally by Sections 66 onwards
Company purchases its own securities	Capital may be reduced by various statutory methods
Specific buy-back conditions apply	Separate Tribunal procedure applies
Securities purchased are extinguished	Capital is reduced according to the approved scheme
Used for capital restructuring/shareholder exit	Broader capital reduction mechanism

23. Advantages of Buy-Back

1. Efficient use of surplus funds

Excess cash can be returned to shareholders.

2. Improved EPS

Reduction in outstanding shares may increase **earnings per share**, if earnings remain constant.

3. Increase in shareholder value

A buy-back can provide shareholders with an exit opportunity.

4. Capital restructuring

It can help the company achieve an appropriate capital structure.

5. Confidence in company

A buy-back may sometimes signal management's confidence in the company's financial position.

24. Possible Disadvantages

Buy-back may also create risks:

- reduction in liquidity;
- excessive use of company funds;
- increased leverage;
- possible manipulation of share price;
- disadvantage to creditors if improperly undertaken;
- unequal treatment if statutory procedures are not followed.

Therefore, the law imposes strict safeguards.

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25. Important Sections

Section	Provision
68	Power of company to purchase its own securities
69	Transfer to Capital Redemption Reserve
70	Prohibition of buy-back in certain circumstances

Memory Trick:

68 → Buy-back

69 → Capital Redemption Reserve

70 → Prohibition

26. Examination Flow Chart

Draw this:

Company proposes buy-back↓Articles authorise it↓Board resolution / Special Resolution↓Check 25% limit↓Check debt-equity ratio↓Fully paid-up securities↓Declaration of Solvency↓Buy-back↓Extinguish securities↓Capital Redemption Reserve, where applicable↓File return

27. Example

ABC Ltd. has:

- paid-up capital = ₹40 crore
- free reserves = ₹60 crore

The company has sufficient financial resources and proposes to buy back its own fully paid-up equity shares.

Before proceeding, ABC Ltd. must examine:

1. whether its Articles authorise buy-back;
2. whether shareholder approval is required;
3. whether the buy-back falls within the statutory limit;
4. whether the post-buy-back debt-equity ratio complies;
5. whether there is any statutory prohibition;
6. whether the declaration of solvency is required;
7. whether the securities are fully paid;
8. whether the securities are properly extinguished;
9. whether required filings are completed.

28. Can a Company Buy Its Own Shares?

Answer:

Yes.

But it cannot do so freely.

The Companies Act, 2013 permits buy-back subject to **Sections 68–70** and applicable rules/regulations.

Therefore:

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“A company can buy back its own securities, but only in accordance with the statutory conditions.”

29. Important Case/Regulatory Point

For a modern LL.M. answer, it is better to emphasise the statutory framework rather than rely heavily on old case law because buy-back is now comprehensively regulated by the Companies Act and, for listed companies, SEBI regulations.

30. Conclusion

The Companies Act, 2013 recognises the right of a company to buy back its own securities but places substantial restrictions on the exercise of that power. Sections **68, 69 and 70** provide the core framework dealing with authorisation, limits, sources of funds, solvency, extinguishment, capital redemption reserve and prohibitions.

The purpose is to allow companies to restructure their capital and return surplus funds to shareholders while protecting creditors, shareholders and the financial stability of the company.

⭐ **Best LL.M. examination conclusion**

“Buy-back is a legitimate mechanism of corporate financial and capital restructuring, but it is not an unrestricted right. Sections 68–70 of the Companies Act, 2013 seek to balance the company's commercial freedom to restructure its capital with the need to protect creditors, shareholders and the solvency of the company.”

🔥 **2-Minute Revision**

SECTION 68 → BUY-BACK

Remember:

Articles authorise↓Board/Special Resolution↓25% limit↓Debt-equity ratio↓Fully paid securities↓Solvency declaration↓Buy-back↓Extinguishment

SECTION 69 → CRR

Nominal value of shares bought back from specified sources → **Capital Redemption Reserve**

SECTION 70 → PROHIBITION

Certain defaults → **Buy-back prohibited**

⭐ **Golden line:**

“A company can buy back its own securities, but only subject to Sections 68–70 and the applicable rules and SEBI regulations.”

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TOP 10 PRIORITY

1. **Separate Legal Personality of a Company**
   — Meaning, characteristics, legal consequences and leading cases.
2. **Lifting of the Corporate Veil**
   — Meaning and circumstances in which the corporate veil may be lifted.
3. **Doctrine of Ultra Vires**
   — Meaning, effects, exceptions and leading case law.
4. **Doctrine of Constructive Notice**
   — Meaning, purpose and legal effect.
5. **Doctrine of Indoor Management**
   — Rule in *Royal British Bank v. Turquand* and its exceptions.
6. **Memorandum of Association (MOA)**
   — Meaning, contents, importance and alteration.
7. **Articles of Association (AOA)**
   — Meaning, contents, alteration and legal effect.
8. **MOA vs AOA**
   — Detailed distinction, relationship and effect of conflict between them.
9. **Promoters of a Company**
   — Meaning, legal position, fiduciary duties, liabilities and pre-incorporation contracts.
10. **Prospectus and Misstatement in Prospectus**
    — Meaning, contents, liability for misstatements and remedies.

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